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MINERAL ROYALTY COLLECTION, ACCOUNTING, AND DISTRIBUTION

ORIGINAL

HEARING

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

TO CONSIDER METHODS OF COLLECTING, ACCOUNTING, AND DISTRIBUTING MINERAL ROYALTIES AND RELATED ISSUES; AND TO REVIEW THE REPORT OF THE COMMISSION ON FISCAL ACCOUNTABILITY OF THE NATION'S RESOURCES

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MINERAL ROYALTY COLLECTION, ACCOUNTING, AND DISTRIBUTION

THURSDAY, JANUARY 28, 1982

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, D.C.

The committee met, pursuant to notice, at 9 a.m., in room 3110, Dirksen Office Building, Hon. Malcolm Wallop, presiding.

Present: Senators Wallop, McClure, Warner, Nickles, Bumpers, and Bradley.

Also present: Tony Bevinetto, professional staff member; D. Michael Harvey, chief counsel for the minority; and Thomas B. Williams, professional staff member for the minority.

OPENING STATEMENT OF HON. MALCOLM WALLOP, A U.S. SENATOR FROM THE STATE OF WYOMING

Senator WALLOP. Good morning. Welcome here, Mr. Griffith, Mr. Linowes, and later Secretary Watt. This hearing is the second in a series of hearings to consider methods of collecting, accounting, and distributing mineral royalties, and to review the report of the Commission on Fiscal Accountability of the Nation's Energy Resources.

The Energy and Natural Resources Committee has jurisdiction as the title implies over all energy matters, legislation, and natural resource protection, extraction, regulation, and distribution. The committee is responsible for legislation pertaining to and authorization of all activities of the land managing agency. In short, consideration of the Mineral Leasing Act, as amended, is the responsibility of the Senate Energy and Natural Resources Committee.

The activities of the Department of the Interior's land managing agencies, USGS, BLM, and others are the legislative responsibility of this committee.

This is a hearing of the full committee. The two subcommittees having responsibility in this area are the Public Lands and Reserved Water and Energy and Mineral Resources. The first I chair and the second Senator Warner chairs. Senator Warner will join us in just a few minutes.

As many of you know, the committees of Congress are the working bodies where investigation and oversight are studied. In the legislative flow, the subcommittee hearing process is the first step to see what is needed, what is going on and what should be done. Since we have two subcommittees involved in this issue, the full committee hearing is called and here we are again.

With projections of $4 billion in royalties from Federal and Indian mineral leases in 1981 and $16 billion by 1990, we believe that the procedures for accounting, auditing, and distribution of these funds should be accurate and not subject to questions of fraud or mismanagement.

During the past year serious concern has emerged over the accuracy and completeness of the present mineral royalty management and collection system within the USGS of the Department of the Interior. I might say during the past year the interest has heightened and it has been a matter of some concern over this matter about 4 years and as we have become closer to it, it became more obvious that our need was slightly greater than had been anticipated.

Charges of inefficient, inaccurate, and incomplete accounting procedures along with accusations and convictions for theft resulted in Secretary Watt taking the bull by the horns and recognizing a 20-year history of mismanagement, courageously established an independent Commission on the Fiscal Accountability of the Nation's Energy Resources, commonly called the Linowes Commission.

It was to review ongoing activities, evaluate the royalty accounting system, recommend improvements in controls and review actions to guard against oil thefts. The Commission made recommendations to the Secretary of the Interior and the President last week.

The Senate Energy and Natural Resources Committee began a parallel inquiry with an oversight hearing in Casper, Wyo., August 11, of last year on the collection, accounting, and distribution of royalties.

The following issues have surfaced in the course of these discussions with respect to the management of royalty collections.

One, there is a need for closer coordination with the States, Indian tribes and others in developing an improved royalty management system. I will ask unanimous consent that the details of these various identifying things be perserved in the record that was just delivered because the idea is not for me to prepare the witnesses, but there is as well a question of royalty underpayments. There are questions of auditing funds and how we can improve upon those and the contracts for look back audits that have been issued to several CPA firms.

And there is the question of collection and it was in this area that it was Jim Watt who has moved quickly to establish the mineral and management service to administer royalty collection and management following the recommendations of Mr. Linowes and his Commission.

And then, last, there is the question of penalties, for delinquencies and the issue of theft in the oil and there are other obviously corollary issues which affect those. And I just want to say that I am pleased with the response of Secretary Watt in establishing a Commission and, Mr. Linowes, I am very pleased with the way your Commission has acted so promptly and came out with a very detailed report that will be of great assistance to the country.

Now, it is important that we have continuing close coordination and cooperation between the Commission and the Department and the Commission and we should insure a complete and thorough as-

sessment of all of the relative issues and subsequent implementation of improved royalty collection and a management system.

At this end I will trust the committee to hold additional hearings to coincide with the administration of legislative recommendations and to allow other Senators to participate. I would say and have said over the course of time that there has been trouble getting a response from this administration. I don't know how a quicker response could have taken place for an issue that has been in front of us for 20 years to finally come to some positive parallel and begin to have positive action taken on it. I think it is a great compliment to all involved.

The first witness is Mr. David Linowes, Commission on Fiscal Accountability of the Nation's Energy Resources, commonly called the Linowes Commission. Mr. Linowes, good morning. Thank you for your cooperation.

STATEMENT OF DAVID F. LINOWES, CHAIRMAN, COMMISSION ON FISCAL ACCOUNTABILITY OF THE NATION'S ENERGY RESOURCES

Mr. LINOWES. Thank you very much, Mr. Chairman. I am very pleased to be here today to present the findings and recommendations of our Commission. As you know we were established on July 27, 1981, and were given three specific mandates: One, to investigate the serious allegations of underpayments of royalties and therefore the inadequacy of payments to the Federal Treasury, to Indian tribes and the States; second, to investigate the allegations of theft of oil from Federal and Indian lands and then to recommend how to improve their financial management of the Nation's energy resources.

After 6 months of probing investigations, our Commission has concluded that the Federal royalty management has failed to do its job for our country. Each year hundreds of millions of dollars in oil and gas royalties are being lost. Royalties as revised this year will total some $5 billion, $4 billion last year. That will rise to $8 billion in a few years and several years after that about $9 to about $15 billion.

It is not possible to determine the exact amount of losses due to underreporting of energy companies and to oil field theft because of the very nature of each of these areas. But the fact that the Government's royalty management system lacks the most elementary controls has convinced us that underreporting has ranged from 7 to 10 percent as was cited in the General Accounting Office report in 1979 and is a reasonable estimate.

As a matter of fact the former Chief of the Conservation Division—and that is a division of the U.S. Geological Survey charged with the responsibility for administering royalty management—indicated a task force of his had expressed the opinion that 10 percent was a reasonable figure.

Individual audits have indicated substantial underpayments, in the range of 30 to 40 percent. So therefore that 10-percent shortfall is a real estimate, if not conservative figure, when you are talking about $5 billion of royalties this year and in the range of $500 million and frankly based on the nature of the lack of controls and

management procedures, and I personally feel that is relatively conservative.

Although other estimated losses due to oil-field theft can be made, some experts have projected a range of from 3 to 6 percent. Oil constitutes some 44 percent of total royalties. So the $5 billion royalty collection for this year, 44 percent of that would be over $2 billion applied to these ratios, and you would come up with somewhere from about $60 to $100 million for additional shortfall for theft.

Incidentally, we have submitted a report of testimony, some 30-odd pages. I am not reading from it. What I have done is just summarized some key points from that. I am trying to follow it in general—what is there—for about 10 or 15 minutes.

Senator WALLOP. The whole statement that you have prepared will be inserted into the record for this proceeding.

Mr. LINOWES. The Commission found that the Nation's collection of oil and gas royalties is on the honor system. The Government has no real way of verifying independently how much oil and gas is taken from leases on Federal lands. The producing companies tell us how much they take from our wells and what the value is. Even though the Government has in its possession some documents that would be helpful in determining just what that production is, the production reports, one document, a critical report in our judgment, traditionally for the past decade has just been thrown into a cardboard box rather than comparing it with the sales report, which is the basis for ponderance over the computer. There are no internal controls.

Only a handful of audits have ever been conducted and they revealed some rather significant underpayments. One group gave us the report and some idea of what it is, and we have one of the dependent's items which is a sketch of some of the results of those audits. Site security is deficient. I saw that for myself when I visited the Indian reservations and some of the adjoining oil sites that belong to the Federal Government.

Theft of oil is very common throughout the country and we were all very disturbed to learn that fees and many other unacceptable conditions have existed for over 20 years. We arrived at our recommendations and 60 of them only after receiving testimony from 125 witnesses representing all groups concerned that go out and give us payments.

There were representatives of many Indian tribes who appeared before us as the spokespersons for seven States: Wyoming, Utah, California, South Dakota, Colorado, New Mexico, and Louisiana. These States actually received 87 percent of all royalties paid to the States by the Federal Government for the Federal lands within the boundaries.

Executives from six major energy corporations testified. They were Conoco, El Paso Natural Gas, Exxon, Getty Oil, Gulf Oil, and Amoco, and three independents, Davis Oil, Superior Oil, and True Oil Co. All submitted written testimony was supplemented by oral testimony. The nine companies paid 26 percent of the mineral royalties received by the Federal Government. So we do feel that we have a good sampling.

We had testimony from the General Accounting Office, extensive testimony. They appeared before us 3 times and they were most helpful. If I must say, it is a commendable example of how two different arms of the Government work together for a common objective. The GAO, an arm of Congress and our Commission, an arm of the executive branch, acting controller general, was extremely helpful and helped expedite our deliberations.

We had spokespersons from the Internal Revenue Service as we had from the FBI. Our hearings were supplemented by several onsite inspections and extensive research in Government records. Among the some 60 recommendations, we recommended that there be severe penalties for willful underpayment of royalties.

At the present time the penalty for violation is $50 a day on Federal lands and $500 a day on Indian lands. And it is very seldom, extremely rare that they have ever been assessed. We recommend penalties up to $10,000 a day. We recommend criminal penalties for the purchase of stolen oil and gas be assessed. And stolen oil can readily be sold. There are a number of refiners who have indicated that they will buy oil from anyone who brings it to them, regardless of what the source is.

Crude oil has a very limited market and must be refined. And we urge the establishment of specific control procedures outlined in our report. We believe there should be cooperative arrangements with the States and Indian tribes to help monitor oil and gas sites and share in the auditing of lessees.

We feel there are a number of Indian tribes who are well qualified to participate in some of this work. Some of the tribes have taken the initiative already. The Shoshone and the Arapahoe—I have met with them and their business council and was impressed with the caliber of training and the concern of these tribes.

They have engaged lawyers and county firms and field inspectors and have conducted detailed analyses. As a matter of fact for the first time in history it was these two tribes, the Shoshone and Arapahoe who instituted action for the cancellation of a release because of very, very serious violations. The Blackfoot and the various tribes in Montana and Oklahoma all have inspection teams monitoring much of the work that is going on.

We recommend that the funding for the additional auditors and field inspectors beyond those provided by the regular budget should be provided for a self-sustained special fund to be created allocating one-half of 1 percent of all royalties collected. This would give the administrators a little more flexibility to deal with clearly a very cost-effective function.

We also recommend that the Government increase royalty rates for onshore oil percent and gas be increased from 12½ percent to 16⅔ percent, as a minimum. The 16⅔, is already in effect for offshore. There is no reason why there should be that disparity, and incidentally, the going rate is between 16⅔ and 25 percent, I understand, and a few leases are at 37½ percent.

Of key importance we are convinced it is essential that royalty management function be reviewed and take its proper place in the organizational structure of the Department of the Interior. We believe it should be transferred out of the prestigious, scientifically oriented Geological Survey. The Geological Survey is charged by

our Nation to look after and protect our natural resources, and they have done a most excellent job. It is an unfair burden on them for our system to require them also to become collectors of royalties.

The new organization should be staffed by people with the necessary training and experience to manage a multibillion-dollar financial enterprise. And it is a fact that the scientists mentioned are no match for the skilled financial administrators. And as you indicated in your opening statement, Mr. Chairman, the Secretary has moved quite expeditiously in implementing that recommendation.

Our 267-page report in our judgment provides a blueprint for creating an effective royalty management system for the Nation's energy resources.

Effective oil management need not be costly. Very few of the Commission's recommendations impose burdens, either on the Federal Government or on industry. It is a matter of how the job is done, not a matter of how many people you are using or how much money is spent. Those increases in Government spending, we recommend, are for a larger inspection and auditing staff. Adequate inspection and auditing are essential for an effective financial management system. Without them we have no assurance that the Government is collecting all of the royalties that the oil and gas industry owes the U.S. Treasury, the States and Indian tribes.

Cooperative agreements with the States and Indian tribes will cover extra inspection, auditing and training beyond that which is covered in the regular budget.

Some of the Commission's recommendations will reduce Federal spending at a real savings of dollars. Among these are the recommendation for the requirement for the lessees to submit a payor plan. At the present time, as you know, there are fractional lessees. There are some, perhaps 650,000. We do not know who owes us money. We don't know who owns pieces of this. If they have been sending us the checks, we say thank you, gentlemen, and that is about it. We feel the Geological Survey is presently trying to develop a comprehensive payor plan and as a matter of fact that is one of the early elements of their new, improved management system.

By assigning that responsibility to the lessees where it belongs, we would relieve the Federal royalty managers of the burden of tracking a multiplicity of payors. We feel that new leases should hold the operator of record responsible. That is where it belongs to the operator of record. The lessee who is operating the lease site should pay those royalties to the Federal Government and let them worry about it and who is directing where it comes.

Louisiana handles it that way very effectively, as does Alberta, Canada. They both have effective systems and they both testified before us. There is no reason why it should not prevail here in the Federal Government. Our proposal to relieve Federal royalty managers from the task of collecting windfall profit tax on royalties should also result in savings in all other forms of income taxes. The taxpayer computes the amount of the tax and in this instance for some reason the Geological Survey is computing that tax.

Also we strongly recommend that the administration of this tax be moved over to where it belongs in Internal Revenue Service. They are set up for that reason and they originally had it. Geologi-

cal Survey requested the administration of it for some reason and we urge that it be transferred back. Our testimony from witnesses from Internal Revenue Service indicated that they would be very pleased to take that function back and the spokesperson for the Geological Survey indicated they would be pleased to give it back.

As for the oil and gas industry the Commission's recommendations pose no undue burdens. Those of most consequence to the industry are the payor plans that I just mentioned and the operator of record. That is just normal traditional business practice and for company security plans that meet minimum Government requirements, these requirements are consistent and essential to the industry's contractual responsibility to pay royalties in full.

It can be argued that our recommendation would produce savings for industry and additional savings for Government if there is adequate protection. Our recommendation on the prohibition on the purchase of undocumented oil, or stolen oil, is the appropriate way of attacking the oil theft for all concerned.

Incidentally, theft is extremely widespread. Yesterday morning at 6 o'clock a strike force in California seized 13 people involved in the stealing of oil in that area and they have about five more on their list, I understand. This is accomplished through the sheriff's office of three people who are devoted to dealing with the major problem of oil theft in that State.

It is just a matter of addressing yourself to the issues and proceeding in an effective way. It is not unuseful to request refiners, pipeline companies, brokers or other purchasers of oil to keep on file documents showing the origin of oil that they buy.

The system of adequate consistent penalties that we recommended is fair. The penalties will only be levied on companies who violate the rules is as it should be. It is noteworthy that in commenting on the Commission's draft recommendations, and we did distribute our draft recommendations about 2 months ago, with those that we had in hand and we requested comments before they were put in final form.

And in submitting our recommendations the American Petroleum Institute, their reaction and I am quoting "with the understanding that industry will have the opportunity to respond to specific regulations which might be proposed and that penalties would be commensurate with the severity of the violation within the concept of the sanctions for noncompliance," et cetera.

Several recommendations require legislation. Most do not. I think out of the 60 recommendations seven will require legislation. Presently I understand counsel for the Department of the Interior is studying our recommendations to determine just which ones do, might require legislation other than the seven that we have identified.

Under those it does require recommendations to deal with improving internal controls in which we required that purchasers of oil and gas from Federal and Indian leases submit monthly reports. Those reports are already submitted by the purchasers to the seller and we want to require a copy to come to the Government.

That is a very, very important control document and that is against deduction and reported sales. Secondary is to deter theft. We feel legislation is required, is needed to require that truck haul-

ers transporting oil from Federal and Indian leases be required to carry a run ticket showing rightful possession of the oil.

There is tremendous confusion in the administration of the royalty management function from people out in the field to the type of official of the Geological Survey and we have got effective testimony from both of those. So we need a clarification and the best way to effect that is through legislation.

And, incidentally, the one incident that largely brought most of this material to light and surface and gave it visibility was triggered by an employee of the Geological Survey, an inspector who knew, he was so disturbed over the fact that stealing was going on and everybody in the field seems to know it, and there was a truck on the highway. Well, he had no authority on the State highway, but he stopped the truck. He had no authority to ask for the run ticket but he did and as a result of that incident much of this became visible.

We want Federal inspectors to have the authority to stop trucks which have run tickets. We feel the prohibition of the purchase of undocumented oil will require legislation with criminal penalties for violations. Another area for legislation is to enforce lessees' royalty payments and site security obligations. That would be involving civil penalties, civil penalties for nonpayments, for late payments and as you know, Mr. Chairman, from what has happened in the past, there is a certain carelessness on us as to the profitability in making late payments and just failing to compute the adequate amount of royalties.

And if by some chance the deficiency were discovered they would say we made a mistake and here is our check for $2 million, no interest, no penalty. Starting July 15, we began to assess interest for onshore, and offshore they had begun interest in October of 1980. We have to make it very clear that not only is there interest, but there are severe penalties for late payments, especially with the interest rates in the 15- to 20-percent range.

We feel that reports that consistently have errors should be penalized. There should be penalties for failure to submit the required payor plans so that the Government knows who owes what and for failure by purchasers to submit required reports and, of course, the observation you made in your opening statement and the one I touched, on cooperation with State and Indian tribes is very critical in our judgment and it most likely will require legislation to effect in as broad a scale as we would like it.

Of course, there can be more informal arrangements as we presently have in Wyoming, which was just triggered a few months ago and has been extremely productive and I think Mr. Griffith will talk to that. We feel we should authorize States and Indian tribes to carry out royalty management and functions under cooperative agreements with Federal royalty management. We would authorize the Federal Government to share with States interest and penalties paid for late payments and under-payments. That is the only fair thing to do. Presently even with the very minimal type of interest we are receiving the Federal Government is taking it all. We think it is inappropriate and it should be shared, the penalties and interest should be shared with the States and we need some legisla-

tion to remove some burdens, one, from the Government and another from industry.

From the Government we feel we should relieve the Federal royalty managers the obligation of calculating and paying the windfall profit tax. That would require legislation. From industry we think it is unfair to expect them based on the Outer Continental Shelf, and therefore it would require an amendment to that act to come to Congress if they inadvertently over-pay penalties for offshore.

Companies generally have excellent internal control procedures. They know when they overpay and they bring it to your attention. Offshore they have to go through the long process of going through Congress. We feel that should be expedited and handled administratively.

Mr. Chairman, this is the substance of our, the major elements of our report and the major elements of the submitted testimony. We as a commission are convinced that if this is fully implemented the financial matters from our Nation's energy resources will be fair and effective. I will be pleased to answer any questions.

[The prepared statement of Mr. Linowes follows:]

TESTIMONY OF

DAVID F. LINOWES, CHARIMAN

COMMISSION ON FISCAL ACCOUNTABILITY OF THE NATION'S ENERGY RESOURCES

BEFORE THE

SUBCOMMITTEE ON PUBLIC LANDS AND RESERVED WATER

COMMITTEE ON ENERGY AND NATURAL RESOURCES

U.S. SENATE

JANUARY 28, 1982

Mr. Chairman and Members of the Committee, thank you for inviting me here to discuss with you the Federal government's management of royalties for our Nation's energy resources.

Our Commission has just completed a six-month investigation of royalty management for oil and gas produced from Federal and Indian lands. We held five sets of hearings with appearances by over 125 witnesses; consulted with representatives of States which share in royalties from Federal leases and with Indian tribes, the industry, Congressional committees, and Executive branch agencies; and reviewed the record compiled over more than two decades. We were aided immensely in our inquiry by the hearings of this and other Congressional committees. The General Accounting Office provided most generous assistance under the guidance of Milton J. Socolar, Acting Comptroller General.

Our conclusion, based on these investigations, is that the Federal government has mismanaged royalty collection for more than 20 years. As a result, the U. S. Treasury, the States, and the Indian tribes are losing hundreds of millions of dollars in oil and gas royalties each year.

Our Nation can no longer afford royalty mismanagement. The stakes are too high. Last year, the Federal government collected over $4 billion in mineral royalties (mostly for oil and gas). By 1990, collections are projected to be over $14 billion for the year. For the decade of the 1980's, more than $90 billion will be collected.

Because the government's royalty records are in disarray, it is not possible to give an exact figure for royalty underpayments. We believe the estimate of 7 to 10 percent underpayments, which was cited in the 1979 report of the General Accounting Office, is a reasonable one, given the fact that the government's royalty system lacks the most elementary controls. The handful of major audits that have been conducted in the past have revealed significant underpayments.

It is even harder to estimate the losses due to theft. Some industry officials and oil field security experts believe that 3 to 6 percent of oil production is being stolen. We do know for a fact that security at many Federal and Indian lease sites is lax and is an open invitation to theft.

The Commission found that royalty collection is essentially on the honor system. The U. S. Geological Survey, which has managed royalties since 1925, takes the word of the companies that lease Federal and Indian lands as to how much oil and gas they have produced and how much the product is worth. The USGS does not verify independently the amount of production;

it rarely checks company statements on the value of the product; and it does not even compare on a routine basis the companies' production reports with their sales reports.

Moreover, USGS royalty records are in such disorder that the agency cannot tell which companies have paid and which have not. When the government has discovered instances of gross underpayment of royalties, or of serious repeated violations of the rules for lease site security, penalties have been light or nonexistent.

The Geological Survey is taking steps now to improve royalty management. The agency intends to install a fully computerized system to keep track of royalty payors, and also has plans to include some computerized checks of company reports in the new system. Most of the controls have yet to be designed, however, and no phase of the new system is yet in full operation.

The Commission recognized that royalty management is a demanding, complex task, especially in a time of rapidly rising energy prices and increasing numbers of widely scattered leases. Nevertheless, the job should and can be done much more effectively than it has been in the past.

THE COMMISSION'S INVESTIGATION

Before outlining for the Committee some of our major recommendations, I would like to say a word about the way in which the Commission

proceeded. In our six months of existence, we consulted as widely as possible with all those particularly interested in Federal royalty management. Among the witnesses appearing before the Commission were present and former top officials of the U. S. Geological Survey and other officials of the Department of the Interior, including the Inspector General and the Deputy Assistant Secretary (Policy) for Indian Affairs. We heard from the General Accounting Office, the Internal Revenue Service, and the Federal Bureau of Investigation.

Representatives of seven Indian tribes (the Osage, Shoshone and Arapahoe, Blackfeet, Ute Mountain Ute, Jicarilla Apache, and Spokane Tribes, and the Association of Wind River Allottees) and the Council of Energy Resource Tribes appeared before the Commission. So did officials of seven of the twenty-three states which receive a half share of Federal royalties on minerals produced from onshore leases within their borders. These states -- Wyoming, Utah, California, South Dakota, Colorado, New Mexico, and Louisiana -- received 87 percent of the royalty shares paid to States by the Federal government last year.

Officers of six major oil and gas companies (Conoco, El Paso Natural Gas, Exxon, Getty, Gulf, and Amoco) and of three large independent crude oil producers (Davis, Superior, and True) presented testimony before the Commission. These nine companies paid 26 percent of the minerals royalties collected by the Federal government last year.

The Commission held its five hearings in Washington, D. C., New York City, and Denver, Colorado. Each hearing was accompanied by a business

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meeting. All our hearings and business meetings were open to the public, so that everyone who had an interest was able to follow the progress of our thinking and our recommendations. Moreover, after our first four months of work, we sent our draft recommendations to key representatives of the various interested parties with a request for comments at our fifth and last hearing. Representatives of the States, Indian tribes, the industry, and Federal agencies offered comments--nearly all of them favorable. Many of the comments were extremely helpful to us in putting our 60 detailed recommendations into final form.

The five Commissioners unanimously adopted each of the 60 recommendations.

Throughout our existence we had unstinting support from the Secretary of the Interior, James G. Watt. We are especially pleased that the Secretary, supported by President Reagan, announced last week that the Department is adopting every one of our recommendations. This sort of reception probably marks a "first" in the history of commissions in Washington!

FUNDAMENTAL CONCLUSIONS

Underlying the Commission's detailed recommendations are some fundamental conclusions we reached in the course of our inquiry:

The government's royalty management system must have qualified managers. The scientifically oriented Geological Survey, which now manages royalties, has never been able to supply the active, sophisticated management that is needed. It was largely for this reason that the Commission

recommended removing the royalty management function from the Geological Survey. In a separate office with a clearly defined mission, royalty management can attract managers with the training and experience required.

The Federal government should work more closely with States and Indian tribes. In fulfilling its royalty management responsibilities, the Federal government should cooperate much more than it has in the past with States and Indian tribes, sharing both information and specific tasks, such as auditing and site inspection.

On this point, the Commission was impressed with the willingness of States and Indian tribes to form a partnership with the Federal government in effective royalty management. There are many talents and resources in the States and Indian tribes ready to be employed in such a joint endeavor. Together, we can accomplish a great deal more than the Federal government has ever done in the past, or can do alone in the future.

The oil and gas industry should carry out its obligation, as lessee, to pay royalties in full and on time. The industry, not the government, has primary responsibility for the detailed recordkeeping needed to assure that all royalties are paid. The industry also has the obligation to assure the security of lease sites. The industry, not the government, is best suited to develop effective site security plans, subject to the government's minimum standards.

The Federal Government should perform an oversight role. It must not waste its limited resources on tasks that are industry's responsibility. In managing royalty collection, it should not remain mired in bookkeeping

details that rightly belong to the lessee. Instead, it should develop systematic, independent cross checks of royalties paid and reports submitted by companies, and it should impose meaningful penalties for false statements or gross errors. In helping to prevent theft, the government should not issue detailed, rigid regulations for security of lease sites. Rather, it should monitor the companies' performance in carrying out their own site security plans and should penalize violations.

* * * * * *

Mr. Chairman, perhaps it would be helpful for me to describe in more detail some of the specific problems plaguing the present royalty management system, and the Commission's recommendations to solve them.

INTERNAL CONTROLS

Of the Commission's 60 detailed recommendations, more than one-third are directed toward creating an effective system of internal controls for royalty management.

Well-run organizations use a system of checks and balances, or internal controls, to protect their assets. These checks and balances give reasonable assurance to management that no misstatement of accounts, either accidental or deliberate, is occurring.

Internal controls for the Federal royalty management system should assure that royalty payments are made in full and on time. At a minimum, they should meet the following four basic requirements:

1. Notice of new production: Federal royalty managers must have a record of new production as soon as it begins;

2. Records of amounts due and from whom: The royalty records must show accurately what royalties have been paid, any royalties due, and who is responsible for payment;

3. Verification: Federal royalty managers must have enough information to verify company statements on the amounts of oil and gas produced, the amounts sold, and their value;

4. Penalties: The system must provide adequate penalties to undergird requirements for accurate and timely reporting.

The present royalty management system is so inadequate that it meets none of these minimum internal control requirements.

The new royalty management system as planned by the USGS meets only one of the requirements. The system is being designed to show what royalties have been paid, what are due, and who owes. Whether it will include enough information for verification of company reports on production is uncertain, since that part of the system is not designed yet. It clearly does not provide adequate penalties for underpayment, nor does it offer any system for notifying Federal royalty managers when new production starts.

The Commission's recommendations cover all of these minimum requirements. All are needed for effective royalty management.

Knowing When Production Starts

Today, the USGS has no systematic way of finding out when new production on a lease has begun. If a USGS district engineer wants to keep track of new wells on a current basis, he must resort to a weekly industry publication, Petroleum Information, which reports new wells but does not identify them by lease. The operator's monthly production report, which shows production on the lease well by well, may arrive six weeks to two months after an individual well actually starts to produce.

The startup date of production is a key fact in royalty management. In the first days of production, output is often exceptionally high--"flush production," as it is termed by the industry. If a careless or dishonest operator fails to report the first days of production, royalty losses to the Federal government could amount to thousands of dollars. (A single good onshore well may produce as much as 500 barrels a day. At $30 a barrel the oil produced in one week would be worth about $100,000 of which some $12,500 would go to the Federal government royalty owner, assuming a 12-1/2 percent royalty rate.) Field inspectors in particular need to have prompt reports when new wells start to produce.

The Commission recommended that operators must notify the Department by telegram or equivalent means on the first business day after new production begins on a lease.

Keeping Track Of Payors

The USGS cannot tell from its records which companies or individuals owe royalties, and even loses track of the identity of those who should pay. Ownership of oil and gas leases is commonly divided into a great many shares, or interests. Often, when an interest changes hands, the USGS never finds out about it. If the new interest owner does not pay up voluntarily, the royalty on that share may never be paid. Auditors in the State of Wyoming who are investigating a few selected Federal leases in their State, in cooperation with USGS, have so far helped to collect $1.3 million in delinquent royalties. The project is a new one, and the auditors have not yet tallied all the causes for delinquency, but they have found that "lost payors" are an important cause.

For its new computerized system, USGS plans to establish a separate account for every payment that might be made on all of its 18,762 leases; there may be as many as 650,000 accounts. To establish the new accounts, USGS also plans to track down all the payors who are currently missing.

The Commission believes that USGS has taken over a mammoth record-keeping responsibility that rightly belongs to the lessees (that is, the industry). The Commission is doubtful that Federal royalty managers can

on their own find all the missing payors in time for the startup date for the new system (which is next January). We also believe that keeping up with several hundred thousand payor accounts and the many continuing changes in ownership is a heavy and unnecessary burden for Federal royalty managers.

We are convinced that the industry can handle this job at least as well as the government, and probably better. Certainly, the job belongs to industry, since lessees agree to pay royalties when they sign the lease agreement.

The Commission recommended that Federal royalty managers require the lessee or his agent to submit a payor plan, signed by all payors, indicating the payment responsibility of each. The payor plan would have to be kept up to date.

The Commission also recommended, for the future, that the Department work toward designating an operator of record for each lease, who would be responsible for keeping all records related to royalty payments in that lease.

Verifying Production

Verification of the production reports submitted by companies is essential. Companies can make some serious mistakes in their reports. One company for example, failed to pay royalties on 450,000 barrels of oil produced over nine years from the Lander field on the Wind River Indian

Reservation in Wyoming. The company said it had paid royalties to the wrong owners in this unitized field. This same company had made the same mistake a dozen years earlier (in 1969 and 1970) and had been informed of it by the USGS.

The mistake was discovered by an investigator for the Shoshone and Arapahoe Tribes on the Wind River Indian Reservation. He noticed on a visit to the field that certain wells were producing on the lease which were not reported in the company's monthly production report.

Field inspectors' observations are a vitally important independent source of information for cross checking company reports. Another possible source of independent data is the monthly statements compiled by many purchasers of oil and gas, which could be matched against the operators' (i.e., the sellers') production and sales reports.

Moreover, cross checks of two sets of company-furnished data--those for production and those for sales--can flag irregularities. Because two quite separate branches of an oil or gas company often prepare these two reports, entries in one may not necessarily match those in the other. For example, a comparison of company production and sales data led an investigator for the Shoshone and Arapaho Tribes to the discovery that a major oil company had underpaid the Tribes $264,000 in royalties for 1980.

The Commission recommended that a number of cross checks on company reports be built into the royalty management system. Where possible, the checks should be computerized and automatic -- for instance, comparison of

company production data with sales and royalty data. Also, the Department should seek legal authority to require that purchasers of oil and gas produced from Federal and Indian leases send monthly statements to the Federal royalty managers. These statements could then be compared with the operators' reports.

The Commission noted that reports from inspectors in the field are a resource that is almost completely neglected in the present system. Among the checks field inspectors can make are to observe wells actually in production on the lease (for comparison with operators' reports), to monitor well tests on a spot check basis, and to check the accuracy of meters that register sales. Any irregularities the inspectors observe should be reported to the financial management branch.

The system could operate in reverse as well; that is, the financial branch could flag anomalies that might signal the need for a field visit -- for example, a sudden unexplained drop in reported production.

Determining the Value of Production

Often, underpayments of royalties result from differing interpretation of the rules -- especially the rules for determining fair market value of the oil and gas produced from Federal and Indian lands. For the most part, the USGS has allowed the companies to determine the value for royalty purposes of the oil and gas. In a

few cases, subsequent government audits found that the values set by the companies were lower than USGS regulations allow. Typically, in these cases, a vertically integrated company produced natural gas on a Federal lease, used the gas in its own refinery, and valued the gas at lower long term contract prices rather than at the higher current market prices.

In some of the cases, the additional royalties assessed were very substantial. For example, for one company, the extra assessment was $2.2 million, or more than 30 percent of the royalties actually paid; for another, it was over $7 million, more than 70 percent of royalties paid.

In at least one instance of disputed valuation, industry officials told the Commission they had asked for, and failed to get, consistent guidance from the government. In this case, USGS reviewed Federal offshore natural gas leases and disallowed certain deductions for the costs of processing the gas. The producers were then assessed over $12 million for two years' gas production from the leases.

Establishing firm consistent rules for the valuation of natural gas is especially important. In the few audits to date, that is where the major deficiencies have been. Today, more than 50 percent of Federal and Indian royalties are for natural gas. By 1990, it is estimated that natural gas will contribute 75 percent of the total minerals royalties.

The Commission recommended that by July 1, 1983, Federal royalty managers issue detailed guidance to the industry on valuing oil and gas from Federal and Indian leases.

Audits and Lease Reviews

To discover whether there are still large royalty payments outstanding from the past, the Department is planning to conduct over the next few years lease reviews and "look-back" audits of the larger royalty payors. The Commission was particularly concerned that critical reviews of past royalty payments be undertaken as promptly as possible. Most of our recommendations are directed at improving royalty management in the future. For redressing the failures of the past, look-back audits and lease reviews are essential. States and Indian tribes who receive royalties collected by the Federal government have been actively concerned about cleaning up past accounts.

The Commission recommended that the Department's schedule for look-back audits and lease reviews be speeded up and expanded, and that the leases and companies selected for review should provide adequate coverage of small companies as well as large, onshore operations as well as offshore, and Indian as well as Federal leases.

For the future, audits must not only be more frequent than they are now, but also must be planned, systematic, and integrated into a well-functioning system of internal controls. Results from past audits should be designed into the system, and provision should be made for audits triggered by irregularities -- for example, by computer flags of discrepancies between production and sales reports.

Finally, no system of internal controls will be effective unless it includes adequate penalties.

SITE SECURITY

The Commission gave careful consideration to physical security of lease sites. We concluded that oil thefts are occurring from Federal and Indian leases, and that they deserve serious national attention. There is no doubt that security is totally inadequate on many lease sites.

The USGS crash inspection program of onshore leases last year found 5,000 security violations. A number of witnesses with first hand experience in the field described to the Commission widespread lapses of security and dubious practices which suggest that oil theft is occurring: storage tanks were left unlocked, valves were not sealed, seals were tampered with, large amounts of oil suddenly appeared in waste pits and just as rapidly vanished, and many unauthorized trucks were being seen in the field.

The opportunities for theft are there. The motives are strong with oil at $30 per barrel, and disposition of stolen oil is quite easy.

One approach to improving the security of lease sites would be to hire Federal marshals to patrol them. A quite different approach is to make it clear to the lessees -- that is, the industry -- that they have the responsibility to protect the sites they have leased.

The Commission adopted the second approach. We recommended a system in which companies would develop their own site security plans, subject to minimum government standards. The government, rather than imposing a detailed, rigid, "cookbook" set of regulations, would set forth the minimum standards which company plans must incorporate, and would fulfill an oversight role. Then if companies should violate the security rules in the plans they themselves have submitted, they would be violating government regulations, and would be subject to penalties.

Our recommendation clearly puts the responsibility for preventing theft where it belongs, on the lessees. At the same time, our proposal is practical and flexible. The lessees know the sites, and have agents on many of them. Our recommendation gives the industry the flexibility to solve their specific security problems, while the government meets its responsibilities by monitoring the industry's performance.

The Commission also recommended several measures that will make it more difficult for thieves to steal oil and to sell it. We recommended that:

- Truck haulers transporting oil from Federal and Indian leases be required to carry a run ticket showing rightful possession of the oil;

- Federal inspectors be given the power to stop truck haulers and check for run tickets; and

Purchase of crude oil without a document showing its origin be prohibited by Federal law.

ENFORCEMENT

The Commission emphasized throughout its report the vital importance of firm, consistent enforcement of the rules. At present, inspections are totally inadequate and penalties for violations are not meaningful. We recommended much more frequent inspections, both to check site security and to verify companies' production reports, and tougher penalties.

Inspection

Today, there are 63 USGS inspectors for over 17,500 Federal onshore and Indian leases. These inspectors are responsible for environmental, safety and many other tasks besides those related to royalty management (site security and production verification). In fact, the USGS estimates that field inspectors spend no more than 20 percent of their time on these two functions. The Department plans to hire 37 more inspectors for onshore leases, for a total of 100. But even with this augmented force, only 20 staff years would be devoted to checking site security and verifying production on the 17,500 onshore leases.

We believe a staff of 83 inspectors devoting full time to these two functions is the bare minimum for royalty management purposes. If inspections for other purposes were kept at the present level, the Department would need a total of 163 onshore inspectors. This would allow one full royalty management inspection for each lease site once a year, on

the average. At least this level of oversight is essential to the proper working of the system we proposed: that companies develop their own site security plans, subject to minimum government standards, and that the government then monitor for compliance with the plans.

The Commission recommended in addition that the royalty management office have its own separate, specially trained inspection force. The argument might be made that a "dual" inspection force -- one for royalty management and the other for environmental, safety, and other requirements -- would be duplicative and inefficient. The Commission concluded, on the contrary, that field inspectors will be better trained and more effective if their duties are not defined too broadly. They will be specialists; and they can plan their inspection time to give highest priority to royalty management needs (for example, checking sites that are vulnerable to theft, or verifying production on leases where company reports have been prone to error).

Safety and environmental inspectors will have different specialized skills. They will select sites to visit on the basis of quite different criteria and needs. With 18,700 lease sites (17,500 onshore) it would be a rare occurrence indeed that inspectors from the two different staffs would visit the same site anywhere near the same date.

Penalties

Sanctions for violation of site security rules or for persistent, serious underpayment of royalties are almost nonexistent. The penalties that are imposed (mostly for failure to file reports) are highly incon-

sistent. One USGS office (Roswell, New Mexico) was responsible for 93 percent of assessments for failure to file in 1981. Outside of that office, the assessments last year, as reported to the Commission, were negligible.

Damages that can be assessed at present are low--$50 a day per violation on Federal leases and $500 a day on Indian leases. The Commission recommended new legal authority to assess civil penalties of up to $10,000 a day, depending on the seriousness of the offense.

Of course, the rules for levying penalties must be established fairly and openly, with opportunity for the industry to participate. Once the rules are established, application of penalties must be firm and consistent.

COOPERATION WITH STATES AND INDIAN TRIBES

The States and Indian tribes who share in royalties collected by the Federal government are showing an unprecedented interest in the workings of the system. They are critical of past royalty management by the U.S. Geological Survey, but also recognize that their own involvement has been minimal in the past. Now, many have expressed eagerness to cooperate actively with the Federal government in improving the royalty management program.

States share half the royalties for mineral resources produced on Federal lands within their borders. In fiscal 1980, 23 States shared in royalties for onshore leases; their share was $315 million. The States also benefit from the $900 million dollar Land and Water Conser-

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vation Fund, which is financed by a portion of revenues from Federal offshore leases.

Indian tribes receive 100 percent of the royalties collected from minerals removed from their lands. In 1980, 33 tribes received $164 million in oil and gas revenues, and $33 million for other minerals (including coal, copper, and uranium) produced from their lands.

The Federal government has a legally defined responsibility, as trustee, for proper management of Indian resources. However, concern about underpayment of royalties and oil theft has risen enough that several tribes have hired their own investigators, lawyers, and auditors to protect what they consider to be their rightful claims.

The States, too, are anxious about Federal royalty management. California has brought suit against the Federal government, demanding an accounting of royalties back to 1920, and the establishment of a more reliable royalty management system. Ten other States--Colorado, Arizona, Utah, New Mexico, Idaho, North Dakota, Montana, Nevada, and Washington--are supporting California as friends of the court.

Many of the States are actively working to improve their own royalty management for State leases and their collection of severance taxes on minerals. The minerals-producing States are also cooperating with each other in unprecedented ways, to make the best use of the talents and resources of each.

As observed earlier, several Indian tribes are vitally interested in improving management of their leases, and are developing abilities in site inspection and financial management. In discussions before the Commission, and in my visit to the Wind River Reservation in Wyoming, I was impressed with the interest shown by tribal leaders in cooperating with the Federal government for better royalty management. The opportunities are there. If given adequate training and resources, tribal inspectors could, I believe, do as good or better job than Federal inspectors, both because they are physically close to the lease sites, and because they have a strong personal stake in the full collection of royalties.

Several States and Indian tribes have already offered to share data and tasks such as inspection and auditing with Federal royalty managers. Wyoming has taken the lead with its cooperative program of reviewing Federal leases within the State, and has already helped to collect over $1 million. Other States have indicated that they want to follow Wyoming's lead. In turn, States and Indian tribes want better, more timely information from Federal program managers to help assure that they are receiving all the royalties they are entitled to.

The Commission recommended that the Secretary of the Interior announce an expanded policy of cooperation with States and Indian tribes. The program should include cooperative agreements, especially for audits, inspection of leases, and training. The Department should enhance the two-way flow of information between Federal royalty managers and States

and Indian tribes, using common data elements for industry reporting, insofar as possible; sharing information on results of audits and site inspections; and making sure that States and Indian tribes have the information they need, on a timely basis, to check the accuracy of their royalty payments.

The Commission did not suggest that the task of royalty management be turned over entirely to States or Indian tribes. The Federal government should remain principally responsible for full collection of royalties due the U.S. Treasury and Indian tribes. At the very least, the Federal government must retain oversight responsibility when the States or Indian tribes, under cooperative agreements, take over certain royalty management tasks.

Also, Federal royalty managers should accept offers of help from States and Indian tribes on a case-by-case basis, taking into account the special abilities of the various States and tribes. In the beginning especially, the Department should monitor closely the projects assigned to States and Indian tribes, or else enter into joint projects. As the early demonstration projects prove successful, and as more States and tribes gain experience and ability in royalty management, projects can be expanded.

The Commission recommended that the Secretary appoint a formal advisory committee including representatives of States, Indian tribes, related organizations, and appropriate officials of the Department, reporting directly to the Secretary's office. Over the next nine months, the committee should develop a detailed, comprehensive plan for carrying out

the policy of expanded Federal, State and Indian cooperation in royalty management.

The Commission also recommended the creation of a self-sustaining fund to pay for extra audits and inspections, beyond those included in the regular budget. The fund would be supported by a small levy (one-half of one percent) on all Federal royalty collections. The percentage could be varied from zero to one percent, at the decision of the Secretary, depending upon needs and disbursements from the fund.

Some spokespersons for Indian tribes argued that it is part of the Federal government's trust responsibility to perform all royalty collection services without charge. The Commission does not agree with this view. The Congress has enacted laws authorizing collection of reasonable fees to cover the cost of work performed, and these laws have been upheld.

I should point out that three-quarters of the contributions to the fund will come from offshore leases (three-quarters of the royalties come from offshore leases). Since all offshore royalties go to the U.S. Treasury, the Federal government would be making far greater contributions to the fund than the Indian tribes or the States.

The Commission believes that special inspections and audits paid for by the self-sustaining fund will repay all its contributors--the States, Indian tribes and the U.S. Treasury--many times, both in additional royalty collections, and in confidence that the system is working fairly and effectively.

ORGANIZATIONAL CHANGES

The Commission noted recent signs of improvement in royalty management. We were impressed by the recognition, both in the USGS and elsewhere in the Department, of the serious faults in past royalty management and the need for change.

Nevertheless, the Commission concluded that royalty management should be moved out of the USGS and into a high level independent royalty management office within the Interior Department. We believe that the Geological Survey's primary scientific and technical mission is inherently inconsistent with the mission of effective royalty management. Scientists and engineers, who are the top managers of the Survey, usually do not make the best royalty managers. USGS royalty management has been a much-criticized failure for more than 20 years. We believe that administration of royalty management would remain inadequate in an agency which is scientific and technical in origin and outlook.

Royalty management is too important for such treatment. It should be in a separate office with a clearly defined mission; where it can attract top quality, experienced, professional managers; where its successes and failures are highly visible; and where its managers can be held accountable by the top leadership of the Interior Department, the Congress, and the public.

The Commission recommended that the Secretary immediately move the royalty management program out of the USGS, to an independent office reporting to an Assistant Secretary or perhaps the Under Secretary. We also recommended that the Department promptly undertake a nationwide search for a director of the office. The most important qualification of the director should be strong management expertise, preferably financial management. Knowledge of the royalty management program or the minerals industry, while desirable, is secondary.

NEW APPROACHES TO ROYALTY MANAGEMENT

The Commission concluded there is no time to waste in improving royalty management. We recommended that the Federal royalty managers proceed as swiftly as possible toward completing and adopting the new, fully computerized royalty collection system. Elements of this complex system should be pretested, on a manual basis if necessary, to establish that they are feasible before full automation is completed. Moreover, we recommended that the Commission's proposals, as adopted by the Secretary, be fully integrated into the new system.

We also emphasized that most of our recommendations can be implemented now, without waiting for completion of the new royalty management system that the USGS is developing. It will be two years at a minimum before all phases of the new system are ready for adoption. Nor should the necessary changes wait until reorganization of the royalty management function is complete. Royalty management can and should be greatly improved starting today.

The Commission recommended that the basic royalty rate for Federal onshore leases and Indian leases be raised from one-eighth (12-1/2 percent) to one-sixth (16-2/3 percent). The rate for offshore leases, for many private leases, and for some Indian leases is already at least one-sixth. The Commission saw no reason for the disparity.

Finally, the Commission was concerned about sustaining interest in and attention to royalty management long enough to assure that constructive, lasting improvements are built into the system. We recommended that the Secretary prepare an annual report on progress in improving royalty management and, specifically, in implementing the Comission's recommendations which are adopted by the Secretary. The report should be submitted to the States and Indian tribes for review, and incorporate their comments. It should be made available to appropriate committees of the Congress and to the public.

COSTS

Effective royalty management need not be costly. Very few of the Commission's recommendations impose significant new burdens, either on the Federal government or the industry. Those increases in government spending we recommend are mainly for larger inspection and auditing staffs.

Adequate inspection and auditing are essential for an effective royalty management system. Without them, we have no assurance that the government is collecting all the royalties the oil and gas industry owes to the U.S. Treasury, the States and the Indian tribes. The Department is currently developing detailed cost estimates for the level of inspection the Commission recommends.

Cooperative agreements with States and Indian tribes will cover extra inspection, auditing, and training beyond what is provided for in the regular budget. To pay for these needs, the Commission recommended the self-sustaining fund I have described earlier. Until the fund is created, some extra appropriations from general funds will be needed for this purpose.

Review of company site security plans by Federal royalty managers will require staff time, and this will involve some extra costs. However, the system should save the government money overall. It will avoid using inspectors' time in unproductive attempts to enforce rules that companies regard as useless. Instead, it will spend government staff time and money productively, establishing plans that the companies themselves have developed and agree to, which can then be effectively monitored by the government.

Other Commission recommendations that involve some increased spending are already covered in the supplemental budget request drafted by the Department last fall to coyer costs of implementing the new royalty management system as planned by USGS.

Some of the Commission's recommendations will reduce Federal spending. Among these are the requirement for lessees or their agents to submit a payor plan, thus relieving Federal royalty managers of the burden of tracking a multiplicity of payors; the operator-of-record concept, for the same purpose; and the proposal to relieve Federal royalty managers of the task of calculating the Windfall Profit Tax on royalties for oil from Federal and Indian lands.

As for the oil and gas industry, the Commission's recommendations impose no undue burdens. Those of most consequence to industry are for payor plans, for an operator of record, and for company security plans which meet minimum government requirements. These recommendations are consistent with -- indeed essential to -- the industry's contractual responsibility to pay royalties in full. It can be argued that they would produce savings for the industry in addition to savings for the government.

Other recommendations, such as the required submission of purchasers' statements to Federal royalty managers, or the requirement that truck haulers carry run tickets, are consistent with current industry practice. Our recommended prohibition on the purchase of undocumented oil is, we believe, a very efficient way of attacking the oil theft problem for all concerned. It is not unreasonable to require refiners, reclaimers, brokers or other purchasers of oil to keep on file documents showing the origin of the oil they buy.

The system of adequate, consistent penalties we recommend is fair. The penalties will only be levied on companies that violate the rules. It is noteworthy that, in commenting on the Commission's draft recommendations, the American Petroleum Institute said: "With the understanding that industry would have an opportunity to respond to specific regulations which might be proposed and that penalties would be commensurate with the severity of the violation, then the concept of sanctions for non-compliance is acceptable."

LEGISLATION NEEDED

The Commission suggested that the most effective way to make the several legislative changes needed for effective royalty management is to design an Omnibus Royalty Management Improvement Act. The Commission recommends that the following elements should be included in such a bill:

1. To improve internal controls in royalty collection

   - Require that purchasers of oil and gas from Federal and Indian leases submit monthly reports to Federal royalty managers

2. To deter theft

   - Require that truck haulers of oil from Federal and Indian leases carry run tickets
   - Empower Federal inspectors to stop trucks and check run tickets
   - Prohibit the purchase of undocumented oil, with criminal penalties for violation

3. To enforce lessees' royalty payment and site security obligations

   ° Authorize civil penalties for site security violations; for nonpayments, late payments and error-ridden reports; for failure to submit the required payor plan; for failure by purchasers to submit required reports

4. To extend cooperation with States and Indian tribes

   ° Authorize States and Indian tribes to carry out royalty management and site security functions under cooperative agreements with Federal royalty managers

   ° Create a self-sustaining fund to finance supplemental audits, inspection, and training

   ° Authorize the Federal government to share with States interest and penalties paid for late payments and underpayments

5. To remove unnecessary burdens from government and industry

   ° Amend the Outer Continental Shelf Lands Act to allow prompt refund of any overpayment of royalties on offshore leases

   ° Relieve Federal royalty managers of the obligation to calculate and pay the Windfall Profit Tax

Mr. Chairman, this in substance covers the major elements of our report. We are convinced that if this blueprint is fully implemented, royalty management for our Nation's energy resources will be fair and effective.

Senator WALLOP. Thank you very much, Mr. Linowes, for your interesting and complete view of the activities of your commission and your recommendation. Senator McClure. Mr. Bradley, do you have questions?

Senator BRADLEY. I was going to wait until you two have finished.

Senator WALLOP. There are several areas of which concern me. One is in the area of natural gas, which accounts for a significant portion of the royalty penalty. How much of the underpayment or overpayment is a matter of—well, genuine mistakes as to the category of gas that might be involved. There are 21 different categories.

Mr. LINOWES. Most of the audits, and there have not been that many, have found that the deficiencies are largely evaluation in the category of gas. There is that problem. One very large deficiency that was just established 2 or 3 months ago was for between 10 and 19 million. The Government has not decided which is the proper range.

The company is contesting that. That is a very important issue and the whole process of evaluation is one that has to be looked into.

Senator WALLOP. Do you have any recommendations in there as to at what point the evaluation might take place?

Mr. LINOWES. We do urge that the Secretary give specific attention to that matter and proceed so that there can be guidance to the administrators. Of course, you had the same kind of problem to some extent with oil until it was deregulated. If gas is deregulated much of the problem is resolved.

Senator WALLOP. One of the problems that exists for a—well, the States, I am sure it is not all that different in other areas, but early on when I first came to Washington and I had some people from the States who approached me and said they were pretty certain that there was reasonably broad spread theft going on.

We tried at the time to involve the FBI in that and were basically unable to because we could not prove that it was going out of State. And it is very, very difficult for a county sheriff to mark oil and track it outside of his county at this time, let alone outside of a State line in that area. And as a consequence now we really never got ourselves in the position of where we could track this out and therefore while everybody was certain, as you have stated that it was widespread, we really could not begin to track it.

But we also found that in the FBI that talent is nonbroad and certainly in order to make that kind of an investigation. Do you have any recommendation to give us?

Mr. LINOWES. We prove that rather extensively. As a matter of fact when Mr. Russak, who had been head of the Denver regional office of the FBI testified before us, and we were pushing him on this issue, and we earlier received testimony that theft appeared to be regional. We had two witnesses who had been employees of the Department of the Interior whose background, one was in the Secret Service and the other one in narcotics as a narcotics investigator, well-trained professionals in the area, they testified the regional is much broader than anyone higher up the echelon is convinced it is.

Incidentally, I found out from my own experience the further down in the field you got, the more convinced people were it was very widespread and prevalent. The higher up in the echelon of the Federal Government the less inclined people were to believe that it was widespread.

They feel that it was a case of a truck load of oil. And he himself said while he was executing his duty, he felt that it was beyond just that local region and in questioning it was said did you submit it to your superiors to indicate your concern and he said yes he did. We said what happened to that and he said, I don't know; maybe I will take the Fifth on that.

We decided to invite him to our next hearing, the chief of white crimes criminal section of the FBI, actually we sent an invitation to the Director of the FBI. He indicated to us that they did not know the answer to that question, but that recently, which would have meant maybe 3 months ago, they had added three or four people to the Denver force to concentrate exclusively on oil.

What happened in California yesterday morning, and I understand there will be at least four or five more people seized in that project, it is evidence that it can be done. Theft is common, if the authorities would just recognize that it is there.

I might add this, as my impressions became made more visible, I guess by the media, the fact that I became convinced that it was regional and not just a local problem, I got a call from a U.S. attorney out in the West and he challenged me on making the statements and I said, have you read or heard the testimony you have received from people who know. And he said no that they did not know the names of the people involved and I referred them to their testimony.

And he said we are convinced it is just an occasional truck load of oil that gets stolen. If you have that kind of an attitude on the part of those who have law enforcement responsibility, then you are naturally going to get the kind of reaction that we have been getting.

And, further, when we do apprehend people that are stealing in Wyoming, your State, as you know in your Indian reservation four pleaded guilty. One was fined $2,500, I think, and another one $10,000 and another just warned. Of course, it was small, but until there is a real determination to proceed effectively, I don't think we are going to get this thing stopped.

And you need the cooperation of industry. Right now what happens, well, there is a going rate that if an employee of the Government or an employee of industry turns his back and allows someone to steal or take oil, he gets $3 a barrel. When a company learns of this, they fire the employee. So then he goes down the road and gets a job with another oil company and beats the cycle.

If the oil companies go to the bother, and it is a bother, and they expose these thieves, I think we can help dramatically curtail what is going on in the oilfields. As you indicated earlier, oil is fungible. Nobody knows what oil comes from where. And therefore it is very important to make sure it is documented.

But equipment, oil equipment is not fungible and there is an awful lot of that kind of theft going on. There are warehouses in Texas which the law enforcement authorities have found pieces of

oilfield equipment from all over the country being stored there. So we do know it is a rather growing problem.

Another point, we had one foreman call our office and tell us that they had instructions to value the quality of the oil lower than it is actually and this is a trucking company with several hundred trucks. Out there in one State the parent of that company, and we turned this matter over to the Inspector General of the FBI, the parent of that company has also been under investigation for other kinds of misdeeds.

You are dealing with an issue that is beyond what conventional wisdom has been up until now.

Senator WALLOP. I think that is true and as a matter of fact it is beyond the capability of local law enforcement throughout the commission and we need some kind of cooperation as that moves beyond their territory.

Mr. LINOWES. Yes, because Federal officials have no right to stop a truck on a State highway. A State highway official has no right to Federal lands. Indians have no rights at all. And they just stand with hat in hand and cannot even look at the meters that are taking the oil out of their wells. And we of course strongly recommend there be a change in all that.

Senator WALLOP. In your report there is a statement on page 14 and that is the following, we recognize that royalty underpayment exists. It is not to say that oil and gas companies intend to fraud the landowners. Your report has been a large outcry that the oil and gas companies are responsible entirely by themselves to the current problems associated with mineral royalties. Would you care to elaborate a little bit on it?

Mr. LINOWES. It does not mean to. If so it is misdirected. It does not mean to point the finger at the oil and gas industry.

Senator WALLOP. I don't think it does. It is those who used the report and nailed away at it.

Mr. LINOWES. The problem when you deal with a subject as complex as this, and you deal with it in a fair and full fashion, anybody who wants to argue can take one piece of that and express it. But the oil companies have a tremendous job. They are very complex institutions. Six of the oil companies, their volume ranges from $20 billion a year to over $100 billion a year, $100 million in royalties, which is important to the Federal Treasury, to the Indian tribes and to the States is only one-half of 1 percent of the $20 billion company.

So from policymaking executives to senior executives of these oil companies and this is not even material. So of that $20 billion one-half of 1 percent, it is something that the top executives cannot tend to.

Therefore to point your finger in serious criticism at the top officials in their complex operations for something that might fall into an immaterial category is unfair. What is fair is for them to make sure there are enough systems and controls and procedures to assure that they are dealing with it properly.

Our market economy is based on the concept of the buyer beware. I think it is very important that we also recognize the seller beware concept especially where the Government is concerned.

Senator WALLOP. I thought what is also fair is that we get on with the recommendations that you have made and put in place something that we can look at in our own affairs.

Mr. LINOWES. And I am extremely delighted that Secretary Watt has moved so expeditiously. Our report is not even due until the 31st. It is not due yet. When the dimensions of this problem were surfacing, Secretary Watt became very concerned, he recognized as we did, problems. Weekly we can anticipate implementation of our recommendations which save the taxpayers, the Indian tribes, and the States some $10 million. That is the rate at which we are losing revenues, no less than $10 million a week.

Senator WALLOP. Have there been as well instances of overpayments as well as underpayments?

Mr. LINOWES. I would be comfortable if there were such instances. There are a few audit reports of oil companies by outsiders, that is by outsiders inspector general, general county audits, the Geological Survey itself. I have not seen one for oil wells. For gas, I did see one, one for about $100,000 and as a matter of fact that is set forth in the appendix as well.

Senator WALLOP. There was a response to your commission, I think, to a question that was asked, I think, in their letter they said 22 adjustments. The letter included a list of 47 nonroutine adjustments made for——

Mr. LINOWES. I am familiar with the letter. They sent that letter to us. And I think that was one of the problems. When we invited chief executive officers as witnesses, they sent their operating people and they were on an operating level and they maintained on the witness stand that there were as many overpayments as underpayments revealed, if not more. They were right. It is their internal control that found the overpayments, you see.

We don't have internal control. We could not find ours. They were protecting theirs, when you get an outside institution, whether it is a CPA firm, an inspector general, or a general accounting office looking at it. We don't find any overpayments. They were finding overpayments so they could get their refunds back, the type of thing I referred to. We were talking different languages.

Senator WALLOP. The USGS agreed generally with the recommendations of your Commission in terms of removing that obligation of accounting and royalty collection from the windfall profit and other things from them to other agencies to other responsibilities. Did they generally accept that?

Mr. LINOWES. The head of USGS, and Mr. Peck is here, and I am sure he would be pleased to respond to that. We moved forward as an independent Commission. We had five independent highly critical Commissioners and we reached our conclusions after hearing at least three times from the top officials of Geological Survey.

It is our considered judgment that this is the approach and you have Secretary Watt here later and I am sure he is going to speak to you of some of the implementations that are now taking place and I doubt that that would be one of them. But we do have a top man from the operation right here.

Senator WALLOP. We will pass that statement. Do you care to comment on that?

Mr. PECK. Yes, I recommended to the Commission and to the individual Commissioners that the royalty accounting function in the long run would be best served as a separate entity from the Geological Survey. And I recommended to Secretary Watt that he move that function out.

The CHAIRMAN. Thank you. Mr. McClure.

Senator MCCLURE. Thank you very much, Mr. Chairman. I am particularly pleased to have you here, Mr. Linowes, and want to congratulate you and the other members of the Commission for the work that has been done and, of course, to compliment Secretary Watt for having undertaken this task.

I think it is well to, and I hope people will, take a look at the qualifications of the members of your Commission, not only yourself, but the other members of your Commission. They have a long range of experience. I think each member of the Commission is to be commended for the kind of work that they have done on the reports you have given us.

They each in their own way, as you, Mr. Linowes, are distinguished in your own field and the public ought to know the kind of contribution that you and the other members of the Commission have made. I am also pleased, of course, that the Secretary of the Interior has moved as promptly as he has, since coming into office, in trying to solve these problems.

It is not a partisan problem and I don't mean to cast it in that light at all, because it has been going on for a long time. I will ask unanimous consent that the biographies of each Commissioner's background be made a part of the record. I think it enhances and undergirds the legitimacy and the accuracy of the findings.

Senator WALLOP. There is no objection to that.

[The biographies follow:]

COMMISSIONERS

DAVID F. LINOWES (CHAIRMAN)

Mr. Linowes is the Boeschenstein Professor of Political Economy and Public Policy at the University of Illinois, and was Chairman of the U.S. Privacy Protection Study Commission from 1975 to 1977. He is former Chairman of the Trial Board, American Institute of Certified Public Accountants, and has headed economic development missions to Turkey, India, Greece, Pakistan, and Iran on behalf of the U.S. Department of State and the United Nations.

MICHEL T. HALBOUTY

Mr. Halbouty is an independent oil producer and operator and holds advanced degrees in both geology and petroleum engineering. He has served as President of the American Association of Petroleum Geologists.

MARY GARDINER JONES

Ms. Jones is a former Federal Trade Commissioner and is President of the Consumer Interest Research Institute. Currently she is Vice-President for Consumer Affairs for Western Union Telegraph Co. Ms. Jones is a lawyer and has served with the Department of Justice in New York City.

CHARLES J. MANKIN

Mr. Mankin is Director of the Oklahoma Geological Survey, Executive Director of the Energy Resources Center, and Professor of Geology at the University of Oklahoma. He was President of the American Geological Institute, and Chairman of the Board of Mineral and Energy Resources of the National Academy of Sciences.

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ELMER B. STAATS

Mr. Staats was Comptroller General of the United States from 1966 to 1981. Previously he served as Deputy Director of the Bureau of the Budget and Executive Director of the Operations Coordinating Board of the National Security Council.

COMMISSION STAFF

Charles L. Elkins, Executive Director: Mr. Elkins has served for more than ten years as a senior manager in the Federal government. He has a degree from Yale Law School and is a member of the District of Columbia Bar.
Daniel M. Rosenfelt, General Counsel.[1]
Paul Jackson Anderson, Assistant Director.
Mary Jane Markley, Assistant Director.[2]
Angeline M. Holowka, Office Manager.
Miriam T. Townsend, Secretary.
Katherine Gillman, Consultant.[3]
David A. Sheridan, Consultant.[3]
William A. Butron, Consultant.[4]
Glen L. Baughman, Consultant.[5]
Michael W. McConnell, Assistant General Counsel.[6]
Douglas L. Caldwell, Consultant.[7]

Mr. LINOWES. Incidentally, each of the 60 recommendations was unanimously approved. I think that is an important element.

Senator WALLOP. I think I should point out for those who might be watching this hearing, it was not all composed of people outside of the industry. There were people well-experienced within it.

Mr. LINOWES. I was asked to select members of the Commission and I actively sought those in the industry. We had oil producers and we actively sought a leading geologist to join the Commission, Charles Mankin.

The CHAIRMAN. Just a brief synopsis, Mrs. Jones is a former member of the Federal Trade Commission and president of a research institute, a lawyer and has served with the Department of Justice. Mr. Mankin directed the Geological Survey, and Elmer Staats was Comptroller General of the United States for many years and a man with a distinguished and impeccable reputation for objectivity as well as Mr. Halbouty.

Mr. Linowes, you have several points in your prepared testimony that refer to the desirability of a system which has severe penalties. I think everyone of us has been involved at one time with respect to the difficulties of enforcing laws and have had to face the choice that must be made at some point; do you have enough inspectors and enough enforcement personnel to almost one per one match the people on the other side, so that you avoid errors or avoid the possibility that they may have done something but in the process build up a governmental structure that is massive in size and complexity are the opposite of enforcement techniques which is have a sufficient force, be able to determine whether or not it is being done honestly by those who have the responsibility for doing it honestly, and then have severe penalties to make certain that

[1] On loan from the Solicitor's Office, U.S. Department of the Interior.
[2] On loan from the Office of Surface Mining, U.S. Department of the Interior.
[3] Full time.
[4] On loan part-time from the Office of Inspector General, U.S. Department of the Interior.
[5] On loan part-time from the U.S. General Accounting Office.
[6] On loan part-time from the U.S. Office of Management and Budget.
[7] On loan part-time from the National Park Service, U.S. Department of the Interior.

those who do not do it are punished as both a warning and an incentive to others to be accurate and honest in their reporting.

You chose the later course, I take it.

Mr. LINOWES. Perhaps I should say in response to your question, Senator, of our 60 recommendations 85 percent of them, not only incur no cost, but I would like to say result in savings to the Government. Nine will incur some cost, but among those that will incur some cost are what we call lookback audits.

Twenty-five companies are responsible for in effect 83 percent of all revenues paid to the Federal Government. And we feel they should be undertaken expeditiously. We have two audits left now and we have a program inspector general of the Department of Interior to proceed with the remaining, the other 23, over the next several years. We feel we want that stepped up to 2 years. That could be an extra cost. That is tremendously cost effective.

And once more that has to do with recruiting all of the items, Treasury, the Indian tribes and the States. Things such as comprehensive training and auditors and inspectors and if the auditors and inspectors, if there is such a fund established as we recommended, skimming off on the royalties, that should not have any impact on anything but these funds.

We do spell out how we would like to see that administered, administered by the Secretary, reviewed and not more than a certain maximum cumulative there. I don't believe there is anything in these recommendations that would permit very frankly the increase in the bureaucracy or acceleration of cost to the Federal Government or to the corporations involved.

The CHAIRMAN. I am very much in favor of the recommendations as I understand them and to the degree that I have had the opportunity to study them. And I am delighted that they are being implemented. I am a little concerned that the magnitude of the job is so great, particularly with respect to lookback audits.

I don't suspect that the fact of the lookback audit is going to stimulate these companies to go back voluntarily through their own book and come forward with any very massive revelation of errors of their own in underpayments in the past. I think we can expect that kind of performance in the future if we have severe penalties.

But if we are going to look back with any degree of success, it seems to me that that is a problem that we are going to have to solve by adding personnel, both adequate in number, adequate in training and expecting that we are going to have to do the job. The companies involved are not going to do the job for us.

Mr. LINOWES. No; it is not expected that the companies will do the job, nor is it expected that the permanent staff of the Department of the Interior will do it. These lookback audits will be conducted by outside contractors. That is the business of CPA's, not that they need business today. But two of them are already under way and one is Texaco and Exxon. And they more than welcomed this kind of assignment. This is traditional work for the certified public accounting firms.

The CHAIRMAN. Similarly, as we look back it is more difficult and in some cases legally impossible to attach stiffer penalties to past misconduct.

Mr. LINOWES. I don't believe we will be able to assign penalties. Well, they were inadequate penalties anyway. And then you have this question of tradition and a number of other elements that enter into it. It is not the penalties so much, we want to at least get back the basic dollar, something that is due us. We have been short changed for many, many years. And our accounting office reports going back to 1959 and 1972 and 1979 have pointed that out, not just with the underpayment of royalties, but there is no interest charged, even when an occasional audit is indicated and there is a deficiency.

The CHAIRMAN. I am very much interested in having lookback audits. I am also interested in the period of time between now and the time when we have the computerized system fully in place and active. I believe you have indicated that may take as much as 2 years to get the system fully in operation.

Mr. LINOWES. Well, it depends on what system you are talking about. We were told when we undertook this assignment that the new improved royalty management system that took care of all ills that it would be a panacea. In our judgment that was never any more than a pipedream.

To this day we do not have a system designed and I am not even quite sure we are going to design a system. You can almost characterize it as a red herring to take pressure off. And we only have one chapter addressed to that element and we suggest ways that it would be nullified.

And incidentally Secretary Watt did not authorize the contract to pursue the installation of this new system and utility until he requested the Commission. As a matter of fact the same day we were sworn in on July 27 and you may recall he requested us that we look into the matter of the contracts that had been submitted for his consideration.

At that time we indicated it was premature to render a decision but on an investigation we learned that the contract could be modified or canceled. And also that that was one of the early contracts and what it largely did was computerize areas that deal with masses of data and that is always good to get data put onto a computer.

So with those caveats we recommended that the Secretary execute a contract and that we would subsequently come in with the recommendation that we have.

The CHAIRMAN. I very much appreciate the work the Commission has done. I am certain that we will ask you some further questions as time goes by and look forward to your response, because there is nothing that is more important than seeing that the recommendations are carried out.

I am sure Secretary Watt intends to do so. I am sure that each of the members of the Commission have looked at this problem with the interest that you have displayed and will also be interested in knowing that they are carried out.

Mr. LINOWES. One of the principal stimulants of the Commission was the enthusiasm with which our Commission was supported by the Secretary and that we had some very intensive sessions, the entire Commission is all very busy and we knew that the Secretary would proceed expeditiously and that was a very important ele-

ment. And I think that resulted in the kind of work product we were able to produce in 6 months.

The CHAIRMAN. Dr. Linowes, I know it was not within the charge of your Commission, but I am sure it must have crossed your mind as well as that of others. If there is this degree of problem with respect to royalty oil on Federal leases or Indian lands, is there a similar problem or the same kind of degree of problem with respect to oil produced on private lands?

Mr. LINOWES. Yes, I am talking about both private lands and—you mean private lands other than private owned by the Federal Government?

The CHAIRMAN. Yes.

Mr. LINOWES. We don't know. I might say that we had two panels of the major oil companies before us and the tone generally was everything is all right; let us leave things alone; maybe it needs a few more audits. Because that was one of the things we questioned.

We were aware that no audits had been conducted for a couple of decades. Just recently there were a handful of audits and I asked one of the panelists, what happens when you lease lands from tribe landowners. And the response was that as soon as we touch a drill to the ground the landowners' auditors are all over our office.

I said then is it fair to assume that your personnel, realizing that private landowners' auditors would be on your property and you will not see a Federal auditor, that they were a little more lax in handling the affairs for the Federal lands, and they said, no, we only have one standard. That is not human nature, as we all know. It is that kind of relationship, complete absence of procedural discipline. That is what it is about.

The CHAIRMAN. There is one area of private landownership or perhaps two that are a matter of concern. One is the question of where you have an integrated unitized oil production facility, a portion of which would be Federal land and a portion of which would be non-Federal. And certainly there must be some kind of a problem of allocation that involves not only the Federal but also the private interest.

The other is the pattern which is not at all unfamiliar in which the mineral ownership is severed from the surface ownership and maybe held in diverse numbers of people many times far away from the site of operation, those small royalty owners, and there are literally hundreds of thousands of them in the United States, have almost no representation with respect to any auditor. They are almost as dependent, well, perhaps even more dependent, on the honesty of the producer than has been the case with the Federal Government in the past.

Mr. LINOWES. Yes, as to the first point you make the land or the oilfield, which I consider is a good example of that, there are five interests there, and the operator, there was such confusion, it has been operated a number of years, that they had to say they were expecting to be able to verify who owns which well that it is coming out.

So they have a system of different color balls in the oil wells and when it comes out to the tank they can confirm who owns what. It was subsequently reported that they had guessed right apparently.

The Shoshone and Arapahoe tribes have a lawsuit and are taking action against the owners of that lease. And they feel that they have been not properly compensated for the oil that has been coming out of their one well in five.

And you do have those problems, but again it boils down to a proper, being properly charged with responsibility to account to the owners. And in this case if they are an Indian or if they are Federal or if they are private, they are all concerned.

I might add this with respect to your second point. The operator of record, the producer should be required to assume his or her fair responsibility and held accountable for what they are taking out and this comes up against the kind of argument that we began hearing at the beginning, but that was laid to rest subsequently by countering the argument. The argument was that oil companies would not permit theft to occur because the Government would only lose 12½ percent, whereas the company would lose 87½ percent, if they had the well.

Well, that is not so, because owners of record, regardless of how big the oil company is, generally fractionize the leases. They may own 20 percent or 10 percent of them or 5 percent. So if there is theft by the participants, the lessee, he is not only stealing from the Federal Government he is also stealing from his partners.

The CHAIRMAN. I am concerned because fractionalized interest oftentimes reduces to the point where the owners of the fractional interest simply do not have the capacity to check or to audit on the production records. They are almost hostage to whatever is reported to them by the producers.

Mr. LINOWES. Yes, but, of course, that is their contractural, the owner of record, the operator enters into a contract with his joint ventures limited partners or however it is packaged and generally do have the right to see certified records.

The CHAIRMAN. They may have the right to see, but they don't know what to look for. I can point to some of my constituents in Idaho who have mineral leases and production interests in the State of Wyoming and I have had occasion to make inquiry on their behalf as to why their royalty payments dropped from $40,000 a month to almost nothing per month with no apparent change in the operation of the oil field.

The responses they get or I get is, well, you don't understand how complex this business is. They really do not, as a matter of fact, understand just exactly why that suddenly changed. And there is some suspicion on the part of some of them that they are getting ripped off just as badly as the Federal Government is.

Senator WALLOP. Certainly not my home State.

The CHAIRMAN. Yes. But I mention this because there is an enforcement problem here that is not just a Federal problem. It does not involve just the Federal Government. My colleague from Wyoming has quite appropriately mentioned the fact that local law enforcement does not always have the resources to follow it through, but under almost every State and statute you don't have very many barrels of oil before you are in grand larceny, if as a matter of fact the oil has not been stolen. I think the same thing would be true with respect to refusal to properly account for the proceeds of that oil.

Now criminal law and enforcement is primarily the responsibility of the States. If local law enforcement does not have the capacity to properly enforce those criminal statutes, maybe we had better look at how we can help them get their job done and if the FBI is called in because of the interstate aspects with a Federal interest involved, they too may need to have greater assets at their disposal to make sure that they are able to discharge their responsibility.

It is not simply a matter of auditing and accounting for the Federal interest. There is a much broader interest at stake too. I wonder if we might use the proceeds of recovery as a source of funding for that multiple law enforcement responsibility. The Federal interest, as a royalty owner, the Federal interest as an interstate law enforcement agency through the FBI or otherwise and the public interest with respect to increasing the capacity of local law enforcement to deal with what has obviously become a very large problem.

Mr. LINOWES. Senator, with reference to the first point you made, we are really talking about two different issues as compared to what we addressed ourselves to here. You see the point you made concerning fractional lease holders, pieces of a lease, you are challenging the honesty of partners. These people have a partnership arrangement. We are addressing ourselves to a seller and buyer situation

The CHAIRMAN. I am not just talking about the fractional leaseholder interest. I am also talking about the fractional mineral owner.

Senator WALLOP. I might say as well that it is not only partners, but Wyoming is a big State and you don't have a person sitting on a tank battery every night. The partners uniformly may be having theft from their tank with trucks driving up in the middle of the night and taking it out. In every instance, it is not just operators who may be involved in that. I think there is a fairly sophisticated group of people that operate in my State and I suspect every other State that produces oil that you can find those unattended with some partner recommendation with regard to security.

Mr. LINOWES. What you have is a complete breakdown of discipline in the oil fields. Frankly in my judgment the Federal Government sets a pattern, because it is so important, this as a unit. And traditionally that has been established in the relationship between the Federal Government and the oil and gas industry and I believe it carries over into the private sector. So if there is looseness here, there is looseness elsewhere.

If we should tighten up and none of our recommendations are burdensome, as I mentioned to either the industry or to the Federal Government, and if we should tighten up and hold industry as well as the responsible Government agency fully accountable for their actions and live up to the trends, it is just good business practice and procedures, and I don't doubt but that there would be a tremendous change in the environment of doing business in the oilfields.

The CHAIRMAN. Just one final comment, and I don't mean to extend the discussion, but I am very much concerned with the non-Federal aspect as well as the Federal aspect here. There was com

ment made about whether or not law enforcement officials could stop a truck on the highway to determine the source of the oil. I think if there is reasonable cause to believe a crime has been committed, local law enforcement in enforcing the criminal statute probably has authority to deal with it. If they don't, that is the responsibility of the State government as well to see that they have appropriate criminal statutes to deal with this.

But in the look-back audit, unlike the change of procedures that we will deal with in the future, we are going to have an extremely difficult task of sorting out willful conduct from simply those differences of judgment and procedure that occur when you have had, as we have in the past, a very complex system of regulation of price and production and divisions of ownership. There can be honest differences of opinion as to what the appropriate accounting is.

I don't desire, and I don't believe it is your recommendation that we attach severe or even attempt to attach severe penalities to the honest differences of opinion, but to make it a careful decision between the willful misconduct from that which may be argumentatively at least the desire on the part of people to minimize the cost and that is arguably a matter of conjecture and some legal interpretation as well as accounting.

Mr. LINOWES. Senator McClure, I would like to make a few observations in response to your comments. One is when we talk about look-back audits, to be conducted by a staff of certified public accounting firms, they can only come in and try to verify and determine if there is a deficiency through tracing audit trails. There is something in the record to hang on to.

There is generally nothing in the record when there is theft of oil. So we are not addressing theft of oil when we are addressing deficiencies through look-back audits.

Further, there are means of determining just what the approximate volume of production of an oil well should be. There is a history. Now, there has been, first, you have high volume and then it comes down and if he can just get some figures, third month of production, eighth month of production, you can chart about what should have been reported.

But let me explain to you one exchange I had with a witness from a major oil company. I said that we have here a record, a production report, a company sending, incidentally, two reports to the Geological Survey, a production report and a sales report.

The royalties are based on the sales report. The production report is just filed. Traditionally they have been thrown in a cardboard box. It is a very, very important control document, however. But as this thing began to surface and the problems began to be of great concern, some people like Charles Thomas and George Hamil, people with little formal education in terms of internal controls, began comparing a production with a sales report for the same company for the same month.

One production report for one major company 35,000 barrels of oil produced that month, the sales report upon which the royalties were based, zero. I asked the official of the company, how do you explain this? And he said, that was just a mistake. I said here is one that shows 15,000 barrels produced, sales zero; another one is

10; I don't recall the figures for that one and the sales were zero. And he said, yes, that was one man that was doing that so we fired him. How do you respond to that?

Why does not the reverse, why don't they report 35,000 barrels for sales and pay royalties on it and production zero? Why not one of those? We don't know. But once more, it is not our job to investigate that. That is for the FBI, the Inspector General, and law enforcement officials. It is our job to build a system where that cannot happen again. We have that system in this blueprint.

The CHAIRMAN. I understand that and that is why I made some suggestion here that maybe we better look at the recovery for both in the future and in the past in terms of division of the money that is recovered. It is extremely cost effective and I think we will find that throughout all of this that it is extremely cost effective and it might well deserve an increased funding to make certain the job is done and the funding needs to flow to three levels; the internal control that looks at the royalty payment as such, the law enforcement functions which are both State and Federal. It seems to me that there needs to be equal attention to the funding of all three approaches.

I appreciate your work. Thank you very, very much.

Senator WALLOP. Mr. Bradley.

Senator BRADLEY. Thank you, Mr. Chairman. Mr. Linowes, I also want to compliment you on this document. I feel that it is very important and I hope that we will follow many of the recommendations. You stated that there is a loss of $10 million per day?

Mr. LINOWES. No. Again, you are playing with averages and sometimes there is talk of $1 billion. I don't know what $1 billion looks like frankly. And who knows what $1 million looks like. When you are talking $500 million or $650 million a year, that I feel is a realistic shortfall. You take that for a week and it comes to $10 million a week.

If you can anticipate the implementation of our recommendation, as currently the department is moving forward to, and with the support of President Reagan, then you are anticipating about $10 million a week.

Senator BRADLEY. How many Federal and Indian onshore leases are there?

Mr. LINOWES. There are about 17,600 leases, which make up something like 60,000 oil wells. We have about 63 inspectors who spend 20 percent of their time inspecting.

Senator BRADLEY. How does that compare to, say, various State inspectors?

Mr. LINOWES. Some States are much worse, and I so testified. I think Colorado has no inspectors and they have an awful system and they admit it, other States the same way. Just turning the whole matter over to the States is insufficient. Louisiana does a good job.

Senator BRADLEY. They have, what, about——

Mr. LINOWES. They have different types of wells.

Senator BRADLEY. What is the inspector/lease ratio?

Mr. LINOWES. I am not sure that I can answer that. Maybe some of our staff would know. One in 13 in Louisiana, one in four in California.

Senator BRADLEY. What is it on the Federal lands?

Mr. LINOWES. As I mentioned you have to divide 63 by about 65. Anybody have a calculator?

Senator BRADLEY. Is that one for every 180 leases?

Mr. LINOWES. It is totally inaccurate. We spell it out in the report.

Senator BRADLEY. You recommend that there be about 80 or 90 more inspectors?

Mr. LINOWES. The exact numbers I don't like. We are not specialists. Nobody on the staff has oil and gas production background. We have two commissioners out of five that do and we understand controls. We understand the absence of controls. If you had an oil well that was producing 20 barrels a month, you can expect that to be inspected as frequently as an oil site that is producing 150,000 barrels a month, and we have those kinds of oil sites.

So what we propose is that, and in our recommendations, the prime responsibility for site security is the companies. We feel the Government should set forth certain minimal standards that are not difficult to devise and let each company decide what site security policies it will use for each of its oil sites and submit them to the Federal Government.

Senator BRADLEY. The same with theft.

Mr. LINOWES. The same with theft and I guess that is what you were discussing essentially when you were talking about inspections.

Senator BRADLEY. That is what the inspector is for.

Mr. LINOWES. They can do many things, that plus they can read the lock meters, which as you know records how much oil has come out. And there are a number of responsibilities that can be assigned to them that also deal with accountability other than theft.

Senator BRADLEY. You have divided it between Federal onshore and the Indian lands. Where are these located in the country? What States are they primarily in?

Mr. LINOWES. I mentioned in my prepared remarks, we invited some seven States as witnesses that constituted something like 87 percent of the States, like Wyoming, New Mexico, Utah, Colorado, California, for example.

Senator BRADLEY. What percent of the oil is produced on Federal and on Indian land?

Mr. LINOWES. A very small portion, because the Federal lands include offshore, offshore maybe 75 percent.

Senator BRADLEY. Of the total production?

Mr. LINOWES. Total of the royalty collected, because we get higher royalties for offshore. We get the 16⅔ percent. We don't get it for most of our wells onshore.

Senator BRADLEY. You recommended in your report that there be a visit to the Indian leases at least once a year.

Mr. LINOWES. That again is a judgmental factor and a minimum of that where you have lease sites that have never been visited in oil history or just occasionally and then the inspectors only spend 20 percent of their time concerned with these aspects in their visit. They are looking at the safety factors and the environmental factors and other things. You need a complete overhaul of the entire function when it comes to inspection.

Senator BRADLEY. In your testimony you talk about the phenomenon of the person that is working for the company who is involved in this illegal act taking a $3 kickback, or whatever it is, and then when he is discovered the company simply fires him and he goes down the road and gets a job with another company. You came back to that two or three times. What specifically do you think we can do about that?

Mr. LINOWES. I think it is just a matter of developing a kind of relationship with the companies that point out that it is in their own interest. One distressing thing to the commissioners, all five, was when the witnesses for the companies, and they were lower level operational which does not mean that they were below level, when a $20 billion, a $150 billion company, somebody at the level that is responsible for operating the Federal leases in the land is not at a lower level. But when they did not even feel there was a problem of theft, theft was no problem for us. But yet almost week after week we now get new indictments.

I mentioned the one bust in California yesterday at 6 o'clock; 13 people picked up, the president of the company, a small company, but nevertheless a refiner, and it is anticipated from the informant that telephoned me yesterday evening that there will be another four or five picked up. When you have these things bursting out in Wyoming, Montana, California, Louisiana, those companies better recognize that there is a problem. I think they have now. Since that time we have had communications with the companies and you referred to this letter Conoco and the American Petroleum Institute requested copies of our recommendations before the report was fully written. They are studying it. There are other indications. The higher tier executives have now begun to look into this distressing condition. Once this happens, then things can very quickly change.

Senator BRADLEY. Are you saying our only role is an 'oversight role to make sure that the bureaucracy is speaking the right words to the industry?

Mr. LINOWES. The only reason I don't respond when you say only, that is the critical role, because if we had carried out that role in the past few decades, I am quite sure we would not have the situation we have today. If we have that oversight we have procedural discipline in effect. Once you have that discipline, when you have inspectors who month after month write out noncompliance reports, because there have been violations onsite, and that is what the inspectors are doing, send it to three channels, nothing happens and then when he comes back and sees the same violation and then his office receives a letter from the oil company, one of the majors on their letter head, I have a copy of a letter, saying in effect some noncompliance reports have been prepared by your office, I have been instructed by, and he names the supervisors, to ignore.

I confronted all of the people with it as witnesses, the inspector who did the job, the supervisor, the employee of Geological Survey, doing geological survey work for over 20 years, 25 years. When I said how can you overrule these noncompliance reports, and I had a stack of them with me, he said I am being made a scapegoat in effect; I am being harassed, it is a matter of judgment.

So when you have these kinds of relationships that have been going on and accepted for decades, you have no discipline and you just have to bring the kind of management in that will end theft.

Senator BRADLEY. This leads to the suggestion that we move away from the kind of scientifically oriented person to an enforcement, auditing oriented person, financial expert person.

Mr. LINOWES. You need some people who are trained in financial matters. It is a multibillion dollar financial enterprise. Would you turn it over to a scientist any more than you could a financial manager into a scientific laboratory? The fact that they were saddled with it is a discredit to our system that required leading scientists of the world to assume responsibility to be royalty collectors.

It is unfair to them. It is also unfair to our Nation. We have to change it.

Senator BRADLEY. How many do we need?

Mr. LINOWES. How many people? The Secretary has asked me to help him identify a person to head up this operation as director of the Mineral Management Bureau and I have two interviews scheduled for this afternoon and two for tomorrow morning. I think once we get the kind of person in there he can help determine.

Again, as I think I mentioned earlier, it is not a matter of how much you spend or how many people you have: It is how you are doing the job. You need people with qualifications to carry out their responsibility. I don't know that we have the personnel. Instead of a scientist, you are going to have to have a financial manager. That is all. You are going to substitute one for the other.

No doubt it is civil service and in the normal administrative requirements, it may take a little time for attrition to wash out one discipline and bring in another discipline, but there would be no overall increase in cost over a period of several years.

Senator BRADLEY. Are there any special considerations that we should have for enforcement on Indian lands?

Mr. LINOWES. No, accepting that Indians are adults. I think that we should: Both the Indians and the Federal Government, have abused their relationship. They have been passive and we have assumed our assertiveness by an act of God almost. I am pleased to read the Supreme Court decision handed down the day before yesterday, the Heckerlia Apache, and they applied a severance tax, which a number of States have which was challenged by oil companies, the Supreme Court ruled in favor of the Indians.

I would like to see a relationship between the Federal Government in this matter and other matters, frankly, with the Indians rather the relationship we have with States. They own their lands and I am impressed with many of the tribes, some need little indoctrination, but the Shoshone and the Arapahoe I am very impressed. I met with their business counsel and I met with several of their key people and spent the better part of a day with them.

They are trained. They are equipped. They are intelligent and they want to assert their interest. And I think we should move forward and encourage. And that is in our recommendations, of course. But there has to be a lot of flexibility. It cannot be cut and dry, because the Osage, for example, have run their own affairs since about 1906 and are doing a pretty good job of it.

That was built into the relationship between our Federal Government and the Osage Tribes. Others just are not equipped to handle it, as is true of the States. So you have to allow the Secretary that kind of prerogative to adjust a relationship, whether it is minimal, as we now have a very ad hoc, more or less, the Wyoming, two of our auditors and four of their auditors or whether it is very intensive. Canada, their system, is the reverse of ours. The provinces run the wells and give half of the royalties to the Federal Government.

I see no objection to having that kind of an arrangement if the State is qualified. There are very few, if any, that are qualified. By their own testimony two or three States stated their management was worse than the Federal Government's. But I think we all need some education in this.

Senator BRADLEY. Take the situation where the well is on the Indian land and there is theft going on. Who enforces to prevent that theft?

Mr. LINOWES. That is the responsibility of the Geological Survey and that is what this report is all about.

Senator BRADLEY. Where would you put that responsibility?

Mr. LINOWES. Wherever, the institution of a high office. The Secretary, as I understand it, is setting it up to be administered where it belongs with good management by managers who understand the administration.

Senator BRADLEY. Thank you.

Senator WALLOP. Thank you very much, Mr. Linowes. If any members of the committee have further questions to ask or who would like to submit some, do that and I would appreciate it.

I appreciate your testimony here this morning. It was a well-laid foundation for progress on the problem that we all agree exists and I appreciate the job of you and all your fellow members. There is a good deal of sacrifice in that. You moved swiftly and did it well and we appreciate that. Thank you very much.

The next witness will be the Secretary of the Interior, Secretary Watt.

STATEMENT OF HON. JAMES G. WATT, SECRETARY, DEPARTMENT OF THE INTERIOR, ACCOMPANIED BY PERRY PENDLEY, DEPUTY ASSISTANT SECRETARY FOR ENERGY AND MINERALS, DEPARTMENT OF THE INTERIOR; AND DALLAS PECK, DIRECTOR, U.S. GEOLOGICAL SURVEY

Secretary WATT. Thank you, Mr. Chairman. I have asked Perry Pendley to join me at the table and Dallas Peck, the director of USGS. Perry Pendley is the Deputy Assistant Secretary for Energy and Minerals, Department of the Interior and is presently the Acting Director of the newly created Minerals Management Service, which we have created to implement the recommendations of the Linowes Commission and run the entity that has been responsible for these general functions.

Mr. Chairman, I do have a prepared statement, but for sake of time, I would just like to highlight that and submit it for the record.

Senator WALLOP. By all means, it will be a part of the record.

Secretary WATT. I think there has been a good bit of attention given to the seriousness of the problem and the magnitude of the problem where you can be alarmed and point back at the problems that existed for 20 years and indeed Dr. Linowes has outlined those well. I think it is a problem and it is difficult to explain why it has not been addressed before.

The facts are when we came in and recognized there was a problem, we started taking action to terminate this hemorrhage of cash that was being lost to the taxpayers and the consumers of America. So we moved aggressively and in February, a year ago, I called the Governors and the Indians' leadership to Washington and we outlined some programs that we thought were needed to undertake so we could get this program in hand. Because it was, as Dr. Linowes points out, just mismanaged.

And the Governors recognizing that they were losing 50 percent of their potential royalties for all things that were mismanaged, fraud, or stolen, except Alaska, which would be 90 percent. And so we started working with the Governors and the Interstate Oil Compact Commission. We doubled the authorized strength of the inspection force during this last year.

In 1980 I point out that there were 16,940 inspections on the onshore, 44,000 to 46,000 wells. In 1981 under my leadership in the Department of the Interior we had 56,000 inspections. Now, why do we have more inspections than we have wells? You need to inspect, as Dr. Linowes pointed out, some wells two and three times a year, while others—stripper wells or well-monitored wells or secure wells—you do not need that kind of inspection.

I want to point out that while we are in the process of doubling our inspection force, we moved inspections from the past administration's policies of between 16,000 and 17,000 inspections to 56,000 inspections this year.

We initiated a lease-by-lease cooperative audit with the State of Wyoming and now we have a similar arrangement going on with other States. I see that Wyoming's Jim Griffith is here, a personal friend of mine for many years, and he frankly deserves the credit for this audit, the joint audit of USGS and the State of Wyoming are carrying out.

In September he cornered me, in an airplane as a matter of fact, as we were flying over Wyoming, and said, "Jim, we had better address this; let us get our auditors from your side and our side and see what we can do." I think Jim is going to testify that we have already recovered about $2 million of unpaid royalties. There are several other million more that are available to us that corporations are checking out and we will pursue that aggressively.

We now have similar such arrangements with other States under way. The State of California yesterday agreed to suspend their lawsuit against the Department of the Interior to start a joint audit, like Jim Griffith has initiated in Wyoming, and he should be commended. He is pioneering an effort with us in Wyoming that will be copied in all of the other States.

Senator WALLOP. Mr. Secretary, I might also add thanks on behalf of the State of Wyoming for the fast way in which you moved to get those identified royalty underpayments that were due the State released in time for them to be of some use for the State.

Mr. WATT. I am sorry you brought that up, Senator. We don't want that word passed around here. Dave Stockman might hear what we did. You forced my hand to deliver that money to the State of Wyoming and I think we have already delivered $400,000 to $500,000 as a share of Wyoming's money, but we would rather have kept it, but because of you personally I OK'd that release. And let us keep that news, Jim, in Wyoming and not let it get out around here in Washington or the other States. Senator Wallop is responsible for that.

We also appointed the Linowes Commission and he has reviewed with you the talent that we had on that Commission and it is such good talent that we kind of determined early on as we saw how they were moving that we would adopt most, if not all, of their recommendations.

When we saw the work product coming, we made a determination that we were going to accept every one of the recommendations that we could as a bare minimum and indeed we have. On January 19, I signed all of the paper work needed to implement all of those recommendations of the Linowes Commission that could be implemented and they have been implemented.

There are a few that could not be implemented because we need congressional authority to implement those. We will be presenting to this committee and to the Congress additional legislation asking for additional authority to create penalties and some of the other things we need. We have a look-back audit going to two companies, Exxon and Texaco, and on January 19 I ordered a look-back audit on 25 of the major oil companies which produce, I believe, 85 percent of the oil and gas on Federal onshore properties and therefore should be responsible for about 85 percent of the royalties received by the Federal Government.

We have made a major change in organization, which was one of the recommendations of the Linowes Commission and that was to remove, they asked that we remove the financial accounting responsibilities from the USGS into an independent entity where you could put managers instead of scientists in charge of it.

In reviewing the recommendations of the several parties, I went further than the Linowes Commission recommended on that point as I have on other recommendations. And we have pulled the entire conservation division out of the U.S. Geological Survey and created a Minerals Management Services, which will be in effect a new bureau. Perry Pendley, as I have already stated, is the acting director of that. We are interviewing, as Dr. Linowes pointed out, two people today and two people tomorrow. I have asked Dr. Linowes if he will not screen and interview those people for us and make a recommendation. We hope to have somebody of a CPA accounting background to head that within the next few weeks.

In doing that we have beefed up considerably and taken control of the financial management responsibilities. In turn, we in my judgment have made a bold, new strong move to enhance the scientific and technological capabilities of the U.S. Geological Survey. Senator McClure had talked to me about this before and Senator Schmitt of New Mexico particularly being a geologist, has pushed me from the very beginning that we take the conservation division

out of USGS. It is a regulatory activity and should not be denigrating the scientific or technological capabilities to the USGS.

So by this management change, I think we have accomplished two major goals that will enhance the Department of the Interior management program as well as enhancing the USGS. So I am particularly pleased with the progress we have been able to establish, the relationships that we have developed with several States, with Wyoming being the lead and I think we have enhanced USGS and most of this credit for these recommendations goes to Dr. Linowes and his outstanding Commission members, it is just an outstanding job that they have done.

We implemented it January 19, and I suppose, Mr. Chairman, that in all Government studies, this is probably the only study that has been totally implemented or will be when legislation is authorized. At least all of the recommendations have been accepted favorably prior to the final submission of the report and as I have told the President with his enthusiastic endorsement, we are implementing everything we can and we are asking Congress for the authority to introduce, to authorize the rest.

There is no dust gathering on this document. It is in effect. It is a splendid contribution and these five people on the Commission work without pay. It was a labor of love for America and they should be commended as highly as the President has commended them and as I continually do and I trust this committee would.

Mr. Chairman, I submit myself and Dallas and Perry for any questions you or the members of the committee might have. I think I have capsulized most of the things.

[The prepared statement of Secretary Watt follows:]

Statement By
Honorable James G. Watt
Secretary of the Interior
Committee on Energy and Natural Resources
United States Congress
January 28, 1982

COMMISSION ON FISCAL ACCOUNTABILITY OF THE NATION'S ENERGY RESOURCES

Mr. Chairman, it is a pleasure to appear before you this morning to discuss the valuable work of the Commission on Fiscal Accountability of the Nation's Energy Resources and to advise you of the actions we have undertaken over the past year to address the royalty management issue and of the plans we have at the Department of the Interior for implementing the Commission's recommendations.

The Department of the Interior derives its authority to lease lands for minerals production and to collect royalties from the production of those minerals through the Mineral Leasing Act of 1920, the Indian Mineral Leasing Act of 1938, the Outer Continental Shelf Lands Act of 1953 and similar statutes. Verification, collection and distribution of these royalty revenues has been a source of controversy for a number of years. As early as 1959, the General Accounting Office found that the U.S. Geological Survey was not adequately managing the royalty accounting function. Similar findings were made in a series of successive GAO reports, the most recent of which was released last October. However, despite these twenty-one years of consistent criticism, little or nothing was done under the six Presidents and their seven Secretaries of the Interior who served between the first GAO report and President Reagan's inauguration.

While I quickly became aware of the questions raised about royalty managment when I assumed office last year, I was frankly surprised at the size of the problem and its complexity. One could almost say that America had no effective royalty

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management system at all. The system wasn't good enough even to tell us whether or not it was working.

We found that total Federal and Indian oil and gas royalties had risen from less than $500 million in 1971 to an estimated $4 billion in 1981 ... and that these royalties were projected to exceed $14 billion per annum by the end of this decade. We found that the USGS had only 47 field inspectors to police 45,000 onshore wells on almost 18,000 onshore leases. In comparison, there were 75 people performing inspections on only 1240 leases offshore. We found that we did not have a reliable means of determining the magnitude of the problem and no practicable way of imposing penalties on those who failed to observe the very few rules and standards extant under that system.

It was because we did not know the dimensions of the problem that we could not accurately focus on overall solutions. We needed to begin improvements immediately and we initiated those improvements even while establishing a commission to give us the sort of fresh, unbiased perspective that only an outside study could provide. It was out of this realization that we asked David Linowes to chair the Commission that now bears his name.

At the same time, but on a separate track, we took a series of actions that appeared from the outset to promise the kinds of reforms that we needed. For example:

--We met with Governors of appropriate States to solicit their ideas and help.

--We invited the Interstate Oil Compact Commission, a multi-state body, to join us in identifying cooperative solutions.

--We more than doubled the authorized strength of the inspection force and began hiring and training additional inspectors.

--We initiated a lease-by-lease cooperative audit with the State of Wyoming and recovered more than $1.5 million.

This is not all we did while the Commission was doing its excellent study and it certainly isn't all we will do now that we have the benefit of the Commission's "blueprint" for improvement. It is, however, the very least we could do while the American people waited patiently for the kind of royalty management program they had a right to expect.

Chairman Linowes has already testified, and I do not want to repeat the points he made. However, I do want to thank him, his four Commission colleagues and their fine staff for their dedication and keen sense of civic duty. Every American owes them a debt of gratitude for what they have done to improve the management of the public's resources.

The Commission made sixty recommendations and we plan to implement all of them. The Commission, for example, recommended that the royalty management function be separated from the scientifically and technically oriented Geological Survey. In response, I moved on January 19th to remove the Conservation Division from the Geological Survey and to re-establish it as the Minerals Management Service. The "MMS" will report to an executive body comprised of the Under Secretary and the Assistant Secretaries for Energy and Minerals and Policy, Budget and Administration. William "Perry" Pendley, Deputy Assistant Secretary for

Energy and Minerals, will serve as acting director of the MMS while we conduct a nationwide search for a permanent director.

The Commission also recommended that we submit legislation to Congress that would give us the legal teeth we need to conduct a better royalty management program, including civil and criminal penalties for noncompliance. In response, I have directed the Department's Legislative Counsel, Theodore Garrish, to convene an intradepartmental task force to draft legislation to impose sanctions and to carry-out other recommendations made by the Commission. I am confident that we will have the necessary legislation available for your thoughtful consideration sometime in March.

The Commission made fifty-eight other recommendations and we will be implementing them in the months ahead. We intend to insure that the American people get a fair return on the sale of their resources. It is possible that we will find that even this comprehensive set of improvements can itself be improved upon. If that should be the case, we will not hesitate to ask Congress for the necessary additional tools to do the job.

We are proud of our record, Mr. Chairman. It's an impressive record, and we are pleased to stand on it.

Senator WALLOP. Mr. Secretary, my compliments to you for moving so swiftly to implement those recommendations. It does seem to me that it is consistent with the administration, that states the desire to clean up areas of waste, fraud, and abuse in the Federal Government wherever they are. I think there are some people who believe we ought to do that. This is an indication that this administration is serious about it and it is important that we do it.

The report you have given us with Dr. Linowes' recommendation, I think should be highly commended.

Secretary WATT. Tnank you.

Senator WALLOP. I will turn to Senator McClure. Do you have any questions?

The CHAIRMAN. I have two or three. Mr. Secretary, first of all, let me state again what I said earlier that I most highly commend you for the diligence with which you have approached this problem. I think it is obvious that there is new emphasis, and there has been for a year almost. You moved very quickly within the first month that you were in that position to get control of this and I commend you for the direction you have given it in that year.

Having said that, of course, let us look at the unfinished agenda and there is much left to do.

Secretary WATT. Yes, there is.

The CHAIRMAN. And I commend you for the action that you have already taken. And as you indicated earlier something that I have not heard for quite some time, I have the highest regard for the scientists that are in USGS. They have an international reputation that has been unparalleled for their scientific expertise and for the professionalism for the kind of job that they do in the scientific land resource field.

I want to maintain that and I think from what we have seen here has been not a denigration of the service but a dilution of their function. I am anxious that we reestablish that and give them their responsibility and allow that to be their charge. At the same time we have a Bureau of Mines that has had some responsibility with respect to public lands and nonpublic lands minerals policy. And I hope we will move just as aggressively to reestablish the role of the Bureau of Mines.

During the last 5 years it has suffered tremendously and I think as a result the Nation has suffered. And perhaps part of our problem in the resources field has been that diminution of the role of the Bureau of Mines and the professionalism that had total and complete industry acceptance. The relationship was a very unique one, because industry knew that the Bureau of Mines was totally objective and totally trustworthy, totally professional.

That suffered in the last 4 years as there was an attempt made or at least the charges were made that the Bureau was somehow in bed with the industry and that it therefore was not a trustworthy Federal agency. As the Federal Government looked at the Bureau of Mines in that way so did then industry begin to look at the Bureau of Mines that way as changes were forced within the Bureau.

Now you are setting up a Minerals Management Service which I think is entirely appropriate with respect to the accounting, auditing functions that are properly a part of your Department. I would

hope that we don't slide the Minerals Management Service into trying to put policy within Minerals Management Service.

It seems to me that we have adequate policy within the other agencies that already exist. And now maybe we need to bring together some of the fractionated policy that may be in the National Park Service, Grazing Service and Fish and Wildlife. We have got a whole lot of different ones with respect to minerals, but I would hope that we don't merge accounting with policy. Would you comment.

Secretary WATT. Yes, thank you, Senator. You have made some extremely valid points and I would like to verify several of the things. You are always kind and talk about allegations. The allegations with regard to the Bureau of Mines, in my judgment, are correct.

It was abused badly the last 4 years, ignored, downplayed, and in fact I was the first one to visit in 4 years. The morale has changed considerably there. I have approved a reorganization of the Bureau of Mines. It will be announced this week to overcome the very concerns that you are expressing there.

We hope to take full leadership of that and restore to it what I think we have commenced to restore with USGS by naming Dr. Dallas Peck to be the Director of USGS. We have gotten back into the tradition of having a career, professional scientist. Dr. Peck was recommended for that position by the National Academy of Sciences and I want to emphasize on the first list of their recommendations and that is a significant point.

He is a career Man. He was the chief geologist for the United States, prior to taking on his directorship, and with restoring professionalism there as we have done, we have done a lot for the morale in creating what you and I think of as the USGS, the sterling group of candidates. We want to do the same for the Bureau of Mines and I think when you see our reorganization you will agree with that.

The CHAIRMAN. Mr. Secretary, when you are ready to do that would you provide a copy of that for the committee? We would be interested in seeing how you are going about this job of reorganization of the Bureau of Mines.

Secretary WATT. I think that is the holdup in the announcement, but we are planning to do that.

The primary function of this new entity has got to be service oriented and the problems that we are now having with oil and gas could come on with coal and the other mineral royalty problems if we don't properly get a hold of those and there is no reason to believe that they have been managed any better than the oil and gas situation. They just are not as big in their dollar volume. So we will need to take control of all of those things. I am encouraged with what I see.

The CHAIRMAN. To underline that latter point, I think there has been some publicity between the last 2 or 3 years about BLM mismanagement of the mineral royalties generally and that did focus, I believe, on some of the coal interest in Eastern States. It is not a western lands question. And I know that you will move just as aggressively on that question.

In response to an earlier question I think there was something said for the record with respect to ratio of inspectors in State programs to the ratio of inspectors to leases. I note that you have used a different comparison in your testimony. You are talking about the ratio of inspectors to wells, the numbers of wells, which seems to me to be a more accurate reflection of workload and interest.

Do you know what the ratio of numbers of inspectors to wells might be under the State programs in California and Louisiana?

Secretary WATT. Dr. Linowes was talking about that and I simply do not know those. The inspectors have different duties and responsibilities. And so even that might be misleading. They check the safety feature of the wells for blowout valves and that kind of thing, for environmental concerns and the like. So we might be comparing apples and oranges just because they carry the name of inspector.

I appreciated Dr. Linowes' handling of Senator Bradley's questions. It would be erroneous for Dr. Linowes or for me to testify to this group that we need *x* inspectors. I don't have any idea how many we need. Whatever we need, we will get. We think we can handle it within our budget for 1982 and what we are submitting to the Congress in 1983. If not we will come back for a supplemental.

But it would be typical if as the Cabinet officer I could come and tell you I can solve the problems if I can reorganize and you will give me *x* million more dollars to hire *y* more people. That is the way Government has handled problems in the past and you can see what has happened for 20 years. I am telling you we will do what is needed. Whatever it takes will be done and we will be accountable for what we are doing.

The CHAIRMAN. As I recall the figure that was used before, and I agree with you that perhaps it is not a fully meaningful comparison in ratios, but if I recall correctly the ratio was 1 to 4 on leases and——

Secretary WATT. That got called out of the audits. I don't know who was speaking, Governor Brown or somebody.

The CHAIRMAN. I don't know how accurate it was, but if it was 1 to 4 and 1 to 13, I think it is fair to note that the ratio off the top of my head is something like 1 to 300 on the Federal leases. And while that maybe is not an accurate comparison, at least the gross disparity would cause us to wonder whether there was some comparison.

Secretary WATT. We have doubled the staff and you divide that in, if that is all the guy is doing is inspecting wells—California I don't know what they have. I do know that they have off the coast within 3 miles of their beautiful shores 3,500 wells. And if they have one inspector for every four wells, that would be the softest job in the world. But those comparisons need to be made.

The CHAIRMAN. I think that was a comparison on a ratio of inspectors to leases rather than inspectors to wells and that could be quite a difference. But that nevertheless is something I think we should look at. I am concerned about two factors and I asked Dr. Linowes some questions along this line too.

I think it is well for us to look at enforcement capability with respect to prospective actions. And we can set up a professional

management team, the audit functions, the penalties, the spot audits, and handle the incentive system to reduce the numbers of people that are necessary with respect to the functions that have to be checked and in which we have to have confidence.

When we look at the look-back audits, we cannot expect that the penalty enforcement system is going to work with respect to the audit of past actions. As I understand, you directed those audits, the look-back audits. Are those being done by contract personnel? Are they being done within the limits of the personnel that are already on board?

Secretary WATT. Those will be by contracts so we can get through them expeditiously with a professional staff.

The CHAIRMAN. I wonder how much action we would get if we called for bids on those contract audits and said you can get 10 percent of whatever you recover.

Secretary WATT. They would be lined up at the door.

The CHAIRMAN. I believe we would have an awful lot of people interested in such an audit. We might even be able to put it out for bid——

Secretary WATT. Might even make money on it.

The CHAIRMAN. We will do it for 1 percent of recovery. One of the staff just said to me we might have staff quit and bid. But we want that job done. I think you do too and we want the assignment of sufficient personnel to make sure it is done. As I said earlier there are three levels. One is to make sure that the Government gets its share of the royalties, whatever the royalty share is. We ought to know we are getting it, that it is being fairly and honestly accounted for.

There are two other functions that are involved. One other function but divided is law enforcement. The criminal side, that people are stealing oil whether they back up with a truck and take it when they are not authorized to take it. It is not their oil and if they simply take it, that is a crime, a crime under State law.

If they also manipulate the books in order to avoid paying what they know they ought to pay, if it is a willful misrepresentation of the facts, that is also a crime. That may be a Federal crime, but it is also certainly a State crime, a crime under State law. The State may not have adequate facilities to vigorously pursue and prosecute those criminal actions.

The FBI obviously has limited capacity to do that as do U.S. attorneys, officers. I think we have also seen and perhaps Senator Wallop could comment because he has been more involved than I, that U.S. attorneys did not want to be bothered with it or refused to be bothered with it and we need to give an incentive to the Department of Justice as well as the tools to do the job.

How about some way of dividing the amount of money that is recovered to provide both the incentive and the capacity for State and local officials who enforce the criminal statute?

Secretary. WATT. I think that you are on to a good concept. The Linowes Commission addresses that in, at least in part and we endorse that. I just earlier this morning spoke to a group of Indian leaders and they pursued this question as well. I visited in Senator Nickle's home in the Osage County and the Osage Indians which have all of the mineral interests in Osage County of Oklahoma and

they have an elaborate and very effective system for monitoring production and security of the sites and the like.

They were asking us to provide more inspectors through the BIA budget so that they could have a better police force on their oilfields. I understand why they wanted that. I told them that I was not likely to do that and that is what I told the Indian community this morning

What we really favor is coming up and asking that like one-half of 1 percent of all royalties be set aside for enforcement, auditing, and the like, so that that pays for its own enforcement rather than being dilluted through a BIA budget or Minerals Management Service-type entity. And when I asked for a show of hands from the Indian community as to how many favored my recommendation versus the Osage recommendation, they all favored our recommendation. Because they do not want the BIA funds being dilluted to help the few Indian reservations that do make substantial money. I think everything ought to pay its own way.

Now, we are paying 100 percent of all of the costs of auditing and inspecting Indian properties while they get 100 percent of the royalties. In like manner in regard to the State of Wyoming which gets about a third of all State royalties paid out, we pay all the administration costs. Of every dollar you get in royalties, They get 50 percent. We pay the administration costs and keep the remainder.

And I am going to ask Congress for legislation that would say let us take the administration, auditing, and inspection costs off the top and then divide 50–50 or with the Indians as the case may be. I think the policing can come through that effort. But that would take legislation and I hope congress will act swiftly and favorably upon it.

The CHAIRMAN. Thank you very much.

Senator WALLOP. Senator Nickles.

Senator NICKLES. Thank you, Mr. Chairman. Secretary Watt, I would like to compliment you. I am impressed with the Commission and the speed in which you have acted. This problem from what I have been able to gather has been here through many administrations.

Secretary. WATT. Yes.

Senator NICKLES. I am really just very favorably impressed over the speed, one, which the Commission was put together, and, two, with the speed the Commission was able to come up with some recommendations of which you wholeheartedly endorse and the speed in which you are moving. I think they will actually save the Government some money, if you want to look at it like that or tidy up some loose ends that have been loose for far too long and everybody recognizes we have been too loose.

No one has been successful as far as addressing the problem. I think you should be complimented in doing so. I missed the earlier part of Dr. Linowes statement. Did you give an estimate of actually what we thought we would be talking about in recouping lost royalties?

Secretary. WATT. First off, sir, yes we did. But let me stress, Senator Nickles, we don't know, our books are so bad that we have no idea of what we have lost, but the auditor suggests that it could be from 2 to 5 to 6 to 10 percent of our revenues and that would put it

in the range of $200 million, $500 million, $650 million counting thefts. That is a half-billion dollars and if you are wrong a few million dollars one way it is still a lot of money that the taxpayers, the consumers of America have lost the last several years.

It has been a problem for 20 years when GAO first in 1959 identified it as a mismanagement problem. And back in those days, of course, oil was not as valuable as it is now. So the dollar value has not been a half billion dollars a year for 20 years, but certainly during the last 2 or 3 years it could conceivably be in that magnitude.

Senator NICKLES. In looking at your chart here and the rapid increase, and I see a lot of increased revenue anticipated for, increased activity, I guess, on the outer continental shelf.

Secretary. WATT. Yes.

Senator NICKLES. Are you assuming an increase in price at any particular rate in addition to that?

Secretary. WATT. There is the increased price, deregulation, and inflation factors put in there. You will see the jump after 1985, I think it is, in that neighborhood. That is when the price will become deregulated under existing law. Some of us think the existing law ought to be changed and in due course somebody will address that issue. But those will vary considerably, but those are the assumptions, yes.

So you get up to $14 or $15 billion within the next 10 years and it is going to keep going up.

Senator NICKLES. The estimated cost, and I certainly compliment you too, there has been some debate among people of how will you increase inspections, is it your suggestion or opinion, can you do that administratively or will that take legislation?

Secretary. WATT. No, we can do that and have done it administratively.

Senator NICKLES. So you are planning on setting aside a fund——

Secretary. WATT. Excuse me, I misunderstood you. To set aside the fund we do need legislation. For the inspections, I have jumped back from the 16,000 to the 56,000 in this past year, just because we care.

Senator NICKLES. On that rapid increase in inspections, have you really seen that that is paying dividends many times over? I am trying to look at the costs versus the revenues.

Secretary WATT. That is a proper question and I think Dr. Linowes discussed that. Once you show that there is a disciplioed enforcement process, the companies get in line to do their jobs. So your first inspections are very beneficial and it would be foolish to suggest that we had to have 56,000 inspections every year on the same number of wells.

Because once they implement the secure facility, you don't need to inspect it as much. If you get a good auditing system you know the production relates somehow to royalty payments and you can kind of monitor the history of that particular well. We have no ability to do that now.

So I think it would be foolish for us to lock in with x number of inspectors. As we show the discipline, monitoring and auditing, we will get around that. So I think what we are doing with the State of Wyoming, Jim Griffith and others will shape up the whole in-

dustry and all the States and they will all come into line quickly and it will be as expensive in the future and, of course, the payout will go down too, because they will be doing the right thing.

Mr. PENDLEY. Senator, if I could add, we have done the audit and the inspection on the Wind River Indian Reservation at the request of the Assistant Secretary for Indian Affairs and, of course, the people in Wyoming and an expenditure of $88,000 recovered some $1.3 million in underpayments. That is a cost effective exercise.

Secretary WATT. For the Indians.

Senator NICKLES. Have you noticed, it is primarily, I think, between States and also between tribes that you have had some States that have been monitored and probably much more lax than say other States and the other part of that is some tribes are much better than other tribes?

Secretary WATT. I personally visited the Osage Reservation and went out to the wells and saw their computerized system. They do an exceptionally fine job, much better than the Federal Government does. They are a first-class outfit. I guess that means we are not. That is what Dr. Linowes found. Not only are we not a first-class outfit, we are a shameful outfit. That is why we have changed. They are all gradations of good and bad there and unfortunately more bad than good.

Senator NICKLES. I noticed in most of the western tribes in Oklahoma, not the Osage or the eastern tribes, but where there are not reservations but where they have royalties, but royalties, they have new-found oil and gas wells over there, but it is much more of a problem.

They are not interested and they don't have the people set yet as far as the administration of some of the royalties. So I think I can sense that there is bound to be quite a bit of disparity between some of the different tribes and between some of the States and I would be interested to see how implementation of some of these things might actually help some of these tribes and States that are not quite as sophisticated.

Secretary WATT. We want to take a hard look at that and so this new Minerals Management Service that we have created will report for the next year at least to a Minerals Management Board that is composed and headed by the Under Secretary and made up of three Assistant Secretaries, the Assistant Secretary for Indian Affairs, Energy and Minerals and Administration, so those three Assistant Secretaries plus the Under Secretary. We are giving high credibility and high input to the Indian interests.

Senator NICKLES. I believe one of the recommendations and this may have been addressed, would be to increase the royalty percentage from 12½ to 16⅔?

Secretary WATT. Yes.

Senator NICKLES. Does this require legislation?

Secretary WATT. Yes, it will and we will be up with that legislation shortly.

Senator NICKLES. What, since this has been public, what has been the public response from different groups, whether they be tribes, the States, the industry, the producers, et cetera, with that increase role of the States?

Secretary WATT. I don't know the answer to that. That is one of the problems with my job, I never get to look back and see what the people think after it. We move on to the next hotspot and I don't know the answer to that. Have you heard any feedback from those?

Mr. PENDLEY. Well, at least the play we have received in the press and the media, the calls we have had have been extremely positive and very supportive. I think one of the conclusions that the Linowes Commission came to was that the Federal Government failed to give proper guidance and direction to the private sector with regard to what we were going to demand of them.

I think many of the recommendations of the Commission are basically telling the Federal Government to get their act together. For example, one of the biggest problems is in regard to natural gas. Fifty-six percent of our royalties today come from natural gas and in 1990 we think about 76 percent will come from natural gas. As a result of the 21 varieties of natural gas pricing and as a result of the various deductions that can be made from the product value, there are very serious disagreements about the value of that product.

What happens in many cases, and the Linowes Commission confirmed this, is that the disagreement about the payment of royalties is the result of differences in the product value and differences in deductible cost. So the Commission says get your act together on that. In addition the Commission says, in regard to the OCS payments and over payments on the OCS royalties, we have to come to the Congress and ask permission of the Congress to make these reimbursements after a 90-day holding period on the Hill.

The Commission says that is an unfair delay and you should be allowed legislatively to immediately repay these over payments. In addition the Commission said that you are demanding too quick a response of the natural gas industry because of the 60-day time that it naturally takes for the information to come in, and so you should wait 60 days before you ask for that royalty.

So these are some positive recommendations of the Commission with regard to the private sector and the Federal Government getting its act together to provide that guidance, so the private sector can be properly responsive.

Senator NICKLES. I think, and you made that point the positive things about the legislative route those things that do require more legislation to increase that royalty, I would expect we will hear quite a bit about it. And we may before that give an indication to you.

Let me ask one other thing that is somewhat related to the recent Supreme Court decision, and if you have not had time to review it, it just came out.

Secretary WATT. The Hickoria?

Senator NICKLES. Yes. Do you have comments?

Secretary WATT. We won, we won.

Senator NICKLES. Where they should have total flexibility?

Secretary WATT. I really have not had a chance to review it, Senator. But, I just have not had a chance to review it, but we generally won our position, but I understand there is a lit of dictum in there about Indian trust responsibilities that my lawyer said that

case will be quoted for the next several decades under trust responsibilities of the Secretary.

Senator NICKLES. Thank you very much.

Senator WALLOP. Senator Bumpers.

Senator BUMPERS. Mr. Secretary, I think this is really irrelevant to this hearing. Which case was it you won?

Secretary WATT. The *Hickoria* case.

Senator BUMPERS. I got the impression you lost. Was that not the case brought by the——

Secretary WATT. Senator, I took an oath of office to be the Secretary of the Office of the Interior on January 23, 1980 and you continue to neglect to recognize that. I am the Secretary of the Interior and I knew I would get that barb from you and so I tried to beat you to the punch.

Senator BUMPERS. You should always come prepared.

Secretary WATT. I am. I am also waiting for a letter of commendation from you on raising the simultaneous bid application price. I am sure that is ready to be signed on your desk and you just have not gotten to me yet. I am prepared, Senator.

Senator BUMPERS. When I first got out of law school—gas in western Arkansas and a bunch of royalty owners came to see me. It was going to be my first case. But the gas companies had very cleverly signed up all of the leases among the very poor people for 10 or 15 cents an acre and they put in the lease that the lessee would receive one-eighth the value of the gas—the value to be calculated at the rate of 4 cents per NCF.

When I looked those leases over, it was with a view that they had been robbed and so I got about 30 royalty owners and I was getting ready to file a lawsuit and the gas companies voluntarily raised it to 7 cents, at which time I lost about half of my clients.

And just before I filed suit they raised it to 14 cents and I lost all of my clients. Until this day most royalty owners in western Arkansas still get one-eighth of 14 cents. You are looking at one. When you talk about raising the fees on simultaneous leases——

Secretary WATT. I knew we would get to this sooner or later.

Senator BUMPERS. A little prefacing remark here. You have raised the payment for bidding on a noncompetitive basis. I have been complaining about the noncompetitive aspect since I have been here. I don't care if you raise it to $1,000 an acre. My point is that the Federal Government ought to be leasing its land on only one basis and that is a competitive basis.

Senator WALLOP. I know how you feel about this, but the point of this hearing is the Linowes Commission report.

Senator BUMPERS. The Secretary raised the point that I had not sent a congratulatory letter and I thought he was entitled to an explanation.

Secretary WATT. I think we can square it off. I came back on Hickoria. You came back on that and we can go on with the meeting of the committee.

Senator BUMPERS. Mr. Secretary, the matter at hand on Indian lands, do we monitor oil produced on Indian lands?

Secretary WATT. We should and are supposed to and have that responsibility and have not done well.

Senator BUMPERS. The Indian tribes before us, you mentioned Osage County, Okla. That is Bartlettsville, is it not? Would we then have a double monitoring system with Interior and the Indian tribe both monitoring the sale of oil there?

Secretary WATT. No. The BIA finances most if not all of that for the Osage Indians now.

Senator BUMPERS. So we do it for them, but we get none of the royalties?

Secretary WATT. We get none of the royalties, correct. They get 100 percent.

Senator BUMPERS. That is done not by the Bureau of Indian Affairs but by BLM?

Secretary WATT. I think it is done by BIA.

Senator BUMPERS. Do we charge the Indians anything for the service?

Secretary WATT. We do not.

Senator BUMPERS. On this question, there is one other problem here, I think, and that is do many States levy a severance tax? If the State has a severance tax on oil, that includes Federal oil. Does it not?

Secretary WATT. Yes.

Senator BUMPERS. If the oil companies or whoever own these leases have been defrauding the Federal Government, they have also been defrauding the States. Have they not? And by defrauding they are not paying severance tax.

Secretary WATT. I cannot speak to the severance tax issue, but the States have lost their 50 percent of the royalties due them and that is why I was commending Jim Griffith from the State of Wyoming, because they have initiated with us in a joint relationship an audit on pass-back and we have already given to the State, recovered $2 million. Their share is up $400,000 to $500,000, already paid to them, because we are going back on that situation. So they have been losing money all of these years as well.

Senator BUMPERS. Dr. Linowes has suggested that we charge the Indians for monitoring their leases. Do you agree with that?

Secretary WATT. Yes, I do.

Senator BUMPERS. Is there any indication that the U.S. Government has not been losing possibly millions and hundreds of millions of dollars since year one on these leases? In other words, the system that is now in place, such as it is, apparently has been the system forever.

Secretary WATT. The system that we now have for royalty management, I understand was implemented in the Eisenhower administration and has not been corrected since.

Senator BUMPERS. I have seen press accounts that we may have lost up to $600 million to $900 million. I don't know where those figures came from. Do you have any estimate yourself based on your information?

Secretary WATT. The Linowes report and their studies indicated that it could be from 2 to 3 to 6 to 10 percent that would make it $200 million up to $500 million for royalty mismanagement.

Senator BUMPERS. How many lessees do they have?

Mr. PENDLEY. Well, according to the Linowes Commission and our records, we could have as many as 650,000 payor accounts.

That is, as you know, Senator, divided lease hold interests and we have received payments from each interest holder. That could work out to as many as 650,000. Many of these people are the same people and they would be paying on several different lease holds and different wells at the same time. So we don't get 650,000, but that is the maximum.

Senator BUMPERS. Dr. Linowes' testimony, which I have been trying to read through because I was not here earlier this morning, suggests that a lot of the things that have happened here involve the theft of oil by third parties.

Do you have evidence that the lessees themselves have been the defrauding parties or do you think most of it is by third parties who are unknown to the lessees?

Secretary WATT. Frankly, I don't know much about that. The FBI and the Department of Justice, the State authorities and our Inspector General are looking into some of those things. I focus my attention on how to correct the management deficiencies rather than the criminal intent behind it.

Senator BUMPERS. Some States have fairly stringent laws on what kind of records will be kept on oil and gas production. For example, in my State the Oil and Gas Commission determines what we call "allowables," on a gas well, you cannot produce gas at its maximum flow rate. The Oil and Gas Commission will almost invariably cut you down to 30 percent of what the well is capable of producing.

The companies also have to submit a report to the Oil and Gas Commission every month reporting how much they are producing. I was just curious as to whether or not the State of Wyoming, for example, has such requirements and if so—well, let me go back. I have some gas wells and they put a little tin house by every gas well and there is a thing on the wall in that house that monitors constantly every minute, every second of the day what the pressure in that well is, what the flow of gas is and when it is shut off and two or three other criterion I don't understand.

It looks just like a heart test. It has about two or three needles on it and those needles go up and down depending on what the pressure is and the flow and so on. Do all wells now have the same thing?

Secretary WATT. I am simply not knowledgeable about that.

Senator BUMPERS. Does anyone with you know the answer to that?

Secretary WATT. Dan Miller is now here. Dan is our Assistant Secretary for Energy and Minerals and formerly served in the State of Wyoming for the last 12 years. Do you want to join us up here, Dan?

Senator BUMPERS. Let me ask that question a second way. I was asking a moment ago, some States require this kind of monitoring device and apparently the Federal Government does not. Is that correct? In our leases, do we not require any kind of monitoring?

Dr. MILLER. We do not require a metering, sir. We require a reporting system of production. But it is not necessarily metered.

Senator WALLOP. When Mr. Linowes was testifying he said that the production records are rarely if ever compared, for example, to the sales record and there is a set of records called production re-

cords, which may not be accurate, I assume, but it is reasonably accurate. There was no insinuation that they were not. There is no thereafter use made of that record.

Secretary WATT. I think all of the evidence that we have is that there has not been good management from the State side or the Federal side and that we as the Fed's side have committed ourselves to bring this up into the 1980's and start exercising good management and States likewise with Jim Griffith's leadership are coming right along with us and we think that will be the case in other States. California, I indicated has agreed now that they will go back to the auditing and we hope to do that with all of the States.

Senator BUMPERS. To get back to the question, is there no requirement, for example, in the State of Wyoming that production at least be monitored or do you know?

Dr. MILLER. Yes, sir, I think I know.

Senator BUMPERS. You are saying there is a way of circumventing the monitor I take it. I want to know how much oil is coming out of the ground. Whether they sell it or not, or how they sell it, is their business. What we want to do, and I assume one of the primary purposes of this hearing, is how we are going to develop a fail-safe system to monitor and know exactly how much oil is coming out of the ground.

Senator WALLOP. The problem there, and correct me if I am wrong, Jim, the problem there is the royalties are assessed on sale.

Senator BUMPERS. The royalties are assessed on sale. If I am Exxon Oil Co. and I am producing oil from a Federal lease, you are telling me that Exxon only pays royalites when they sell the oil, rather than when it comes out of the well on Federal lands? What the hell kind of a system is that?

Secretary WATT. Poor.

Senator BUMPERS. Has this always been the case?

Secretary WATT. It is a poor system.

Senator BUMPERS. I cannot believe that.

Secretary WATT. Maybe when you get back to your office you will sign that letter.

Senator BUMPERS. I do appreciate very much the fact that you are getting into this. It does not surprise me that this situation exists. Nothing ever surprises me around here, but I certainly applaud you for taking the initiative in not only trying to rectify it, but I hope you prosecute the offenders, particularly in those cases where the lessee and the offender is one and the same person. And I expect you are going to find a lot of that.

But I cannot believe that we have a system here where we lease land for people to drill for oil, and say that you can take all of the oil you want and if you happen to sell some of it, send us the royalty on it.

Secretary WATT. Dr. Linowes has made a couple of interesting analogies. He said, No. 1, it has just been run on the honor system and I think Dr. Linowes has used the example that it is kind of like running a hotel where you say to all your patrons, just drop the fees for the hotel in the bucket at the end of the day, and you count the money in the bucket and you say, hey, we are short and

will the right people come forward and pay us the amount of money. I think, Dr. Linowes, that is kind of your analogy on that.

And that is about as accurate, maybe a little bit exaggerated, but we really do not have a good system. We don't know what we have lost.

Senator BUMPERS. Somebody has just told me, and I want to set the record straight, that apparently one of the reasons oil royalties are not assessed at the wellhead is that sometimes you get a lot of things besides oil out of the well, you get a lot of saltwater and that sort of thing. But where is the separation made? Where do you separate the crude from the other trash that comes out of the well?

Dr. MILLER. Well, the initial separation is made right at the site or there may be two or three wells in a little cluster that may use the same separation facility. That is the first separation that is made. But that is the crude separation. I mean it is just a very general thing. It separates the water out.

Other separations are made later in the system after the oil is moved by the pipe-gathering system and pipelines to the refineries. This is partly what complicates this problem, sir, to a great extent. You simply cannot measure the amount of fluid that comes up through a pipe and have a meter tell you that so much of it is oil and so much of it is water.

Senator BUMPERS. There is no such thing as we have on gas wells.

Dr. MILLER. That is right, sir.

Senator BUMPERS. One of the things that troubled me just slightly here is Dr. Linowes' statement that we should clearly put the responsibility for preventing theft where it belongs, on the lessee. I agree that that is where the burden ought to be. It ought to be on the lessee, but there ought to be a very strong monitoring system by the United States to keep the lessee honest. I would not want to put the whole burden on them.

I think we have a responsibility to the people in this country.

Mr. Chairman, I don't have any other questions. It is my feeling, based on the fact that there is no system now in place to monitor what we are producing on Federal lands, that the losses more than likely run more in the billions than the hundred of millions.

I hope that you will keep this committee posted as you proceed.

Secretary WATT. I certainly will.

Senator BUMPERS. Mr. Chairman, if we can have another day before they finalize the proposals, we could have a hearing to discuss those proposals.

Senator WALLOP. By all means. It would be my intent. I would just say that I started working on this a year after I got here. It was brought to my attention and it has finally gotten some action at the executive level.

Senator BUMPERS. Are we only talking about oil here, Mr. Secretary?

Secretary WATT. Oil and gas.

Senator BUMPERS. Do we have evidence that there have been gas thefts also?

Secretary WATT. We have evidence that there is not proper royalty paid for the production of gas and we also have no reason to believe that we don't have similar problems on coal and other roy-

alty issues and this new entity, which I have created, will address all royalty management issues.

The CHAIRMAN. Senator, if you would just yield a moment. I think it would be correct too, would it not, with respect to gas production, it is not as simple as simply metering volumes that flow from the wellhead itself. There are other gases that are not useful that are separated out and you have natural gas liquids that are separated out and oftentimes customarily marketed separately.

So you have to follow not only production records, but also the sales records for natural gas production. Is that not true?

Dr. MILLER. That is correct, sir.

Senator WALLOP. I have one question. It is sort of related at least to the tracking of where things go. That was in the Outer Continental Shelf back in 1978 the Congress directed that 20 percent of the crude oil, natural gas that was produced on lease was issued after that date, to be offered for sale to small and independent refiners.

It was Congress intent to give refiners control of little if any of their own production a chance to purchase a secure supply of crude oil. And it is also my understanding that there was substantially in excess of a million barrels of crude that was produced and sold in the Gulf of Mexico alone.

And it is my understanding as well that the Department of the Interior apparently has no way of knowing whether or not this oil was ever offered to small or independent refiners. There are no procedures specifying the conditions under which that oil was sold. Would you comment on that generally and if not today, could you provide us an answer?

Secretary WATT. Mr. Chairman, I have met with some refiners from the State of Wyoming as a matter of fact, asking that that small refiner program be implemented and the proper allocation be made for production of crude in the Rocky Mountain States and that is being worked on now. And from my preliminary understanding I see no reason why that allocation should not be made. In fact it should be made according to the law and we will address that problem and resolve it hopefully within the next few days.

Senator WALLOP. I am much obliged to that. Could you enlighten the committee on the contributions that were made by the interstate oil and gas, Oil Compact Commission on the mineral revenue issues under this and do you anticipate that they will have an effective role?

Secretary WATT. Yes. I will need help from Secretary Miller on this. Last February when I met with the Governors of all of the States, including the Governor of Oklahoma, we asked that a committee be created through the Interstate Oil Compact Commission to address this problem.

And as a result of that contribution in those meetings, we have implemented several Federal-State relationships. I think there are five of them now, either agreed to or are about to be signed off, which will allow us the audit and the inspection programs, like we worked out with Jim Griffith, and the other States. Dan, do you want to comment on what the other States are, Wyoming and others.

Dr. MILLER. Let me drop back, if I may, sir. You must understand that each of the States has in past history, throughout. History had their own documentation type of accounting system. Each one was very careful about their way of doing it. It has been a very difficult thing to bring the States into any sort of continuity to standardize a form, if you will. The Interstate Oil Compact Commission acting in their capacity as representatives of all of the producing States has been instrumental at the Secretary's request in bringing at least those of us in the Western States into conformance with a standardized system.

Now, the Interstate Oil Compact Commission did not dictate to them what that system would be, but got them to work cooperatively together to come up with a single form. This has not as yet been totally implemented, but the concept is working.

The other thing is, as has already been mentioned, several States have already joined in cooperative efforts and we have letters from some five other States and from other Governors who have indicated their willingness to cooperate or enter into a similar cooperative agreement. It just has not quite taken place yet.

Senator WALLOP. A good deal of this is more important since the price of oil went up of domestically produced oil.

Dr. MILLER. That is right.

Senator WALLOP. I just have one other comment, Mr. Secretary, and I appreciate that you are going to have two interviews this afternoon and a couple tomorrow to find yourself a head of the Minerals Planning Committee that you are setting up, and that the qualifications be somebody well-versed in accounting procedures.

I would hope that that person would also be well-versed in accounting procedures as they relate to the oil and gas industry. I don't think the industry or the Department or the public has time for on the job training in this particular issue. It is too complex for somebody to have to go back to square one and learn all of the intricacies of it.

Secretary WATT. I would hope that we could comply with that request. I have not made it an absolute requirement. We have such difficult conflicts of interest in the statutes, that if somebody is really knowledgeable that person is probably not eligible.

Before, we are about to wind down, I would like to make one other comment, Mr. Chairman, and I realize I am being redundant, but it is something that I want to stress. This Commission, the Linowes Commission as we call it, was made up of five of the outstanding people in their fields.

I cannot express sufficient gratitude to those five people for the commitment they have given these last 6 months, their determination to make a contribution to a better country and they have just done a superb job and I guess the evidence of that in my own point of view is the highest way to commend someone is to accept all of these recommendations and agree that he is real smart. We are accepting all of their recommendations. We have implemented most of them and we hope to have the authority to implement the rest as soon as Congress can act.

Again, my highest thanks to Dr. Linowes and his four colleagues for an outstanding job that was done and not always with the fullest cooperation that should have been given from everybody, but I

think it is a great job and we are using it as a foundation and will build from it. All of their recommendations have been accepted as a minimum not the maximum.

Senator WALLOP. Secretary Watt, I thank you and I must say that I am delighted to see USGS return to the degree of professionals that it once was and has always desired to be and I think there has been real progress in that area.

Secretary WATT. I certainly agree with that statement.

Next, I am particularly delighted to welcome here the State auditor of Wyoming, Jim Griffith and he is accompanied by Randy Fetterolf, the supervisor of the natural resource production audit group.

Jim, I just want to say how pleased I am under your guidance of taking the lead in this cooperative venture between the Department of the Interior and the State.

STATEMENT OF JAMES GRIFFITH, WYOMING STATE AUDITOR, STATE OF WYOMING, ACCOMPANIED BY RANDY FETTEROLF, SUPERVISOR, NATURAL RESOURCE PRODUCTION AUDIT GROUP

Mr. GRIFFITH. Thank you, Mr. Chairman. In the interest of time, I will be brief. You have my prepared statement, I believe.

Senator WALLOP. Which will be inserted.

Mr. GRIFFITH. If I may just add a few comments, Mr. Chairman, and committee members that are still here and distinguished witnesses, I am Jim Griffith, Wyoming State Auditor. With me today is Randy Fetterolf, the Wyoming Natural Resources Production Audit Supervisor.

I do appreciate the opportunity to testify on the recommendations of the Linowes Commission. The State of Wyoming is deeply interested in the matters which have been so ably articulated in the Linowes Commission report. I find the Commission's report and recommendations well founded and urge the general adoption thereof.

Perhaps because we sit in different chairs in different geographical locations our stand is slightly different on a few issues. Secretary Watt is to be commended for appointing such capable people to the Commission and the results of the 6 months of work are most gratifying.

Unless I state otherwise, I support the commission's recommendations and in a few cases would like to emphasize the recommendations. Since August 11, 1981, the last time I testified before this committee in Casper, Wyo., some interesting and fruitful developments in the area of mineral auditing have taken place in Wyoming. This committee will likely be most interested in the fact that on September 11, 1981, Secretary Watt expressed, and he and I

agreed to conduct joint Federal/State audits in Wyoming; 17 days later this program began. We have not been fooling around.

Since then approximately $2 million in delinquent oil and gas royalties have been recovered. Additional demands in excess of $3 million are outstanding at this time and should be resolved in the next 30 to 90 days. My belief in the program is strong indeed. In less than 4 months it is a proven program.

Our major problem is that the Geological Survey, I wish they were here, because of the hiring freeze, has only been able to commit two part-time employees to the audits in Wyoming, while the State of Wyoming has committed two full-time employees. I understand that letters have been delivered to other States and Indian tribes, urging that they start similar audit programs. This is outstanding.

However, the GS is but seeking undeserved attention unless they become full partners in the program.

On November 19, when I testified before the Linowes Commission, the shortage of GS help in the Casper office was addressed. I was given every assurance by high-level GS officials that the situation would be corrected. That was over 2 months ago and the GS has not acted, nor have they even broken silence.

I can hardly imagine the dissatisfaction, the disarray which will prevail when six more States and several Indian tribes descend upon the Casper, Wyo., office. The new Minerals Management Service must face up to this reality.

I have a little difference of opinion with the Commission's recommendation on the so-called lookback audits. Any lookback or post-audit should start with the basic unit, which in this case is the lease of the unit. This is the common denominator, the basis on which we must build our Minerals Management Service.

The past sins cannot be swept under the rug, but must be cleaned up. We cannot have garbage in and garbage out on our computers. We cannot build our future foundation on shifting sands. A property-by-property basis will be cost-effective. In Wyoming we have proven this. For every $1 we have spent, we have had $8.50 returned and we are just getting started. I doubt if a company-by-company lease that is being proposed will prove nearly as cost-efficient.

The Commission's report downgrades account balances into insignificance. Wyoming's experience is that account balances, despite the inaccuracy of the USGS accounting are excellent red flags.

I am so pleased that the Commission's report takes the position that Wyoming has had that we should share in the interest and penalty payments. The fairness of this recommendation is self-evident.

The Linowes Commission has made a great start in solving a long festering problem. The recommendation to create a 9-month Secretarial Advisory Committee could well heal the wounds of the past. The State of Wyoming stands ready, willing, and able to be of assistance, should such assistance be of value. And perhaps the best help the State of Wyoming can provide to other States is to make available our comprehensive audit program. This program was developed using generally accepted audit principles and our

experience. It should help other States avoid the pitfalls that we have this far encountered.

Mr. Chairman, I will be happy to answer any easy questions.

[The prepared statement of Mr. Griffith follows:]

TESTIMONY GIVEN BY JAMES B. GRIFFITH,
WYOMING STATE AUDITOR

BEFORE THE SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
WASHINGTON, D.C.

ON JANUARY 28, 1982

Mr. Chairman, Committee members and distinguished guests, I am Jim Griffith, Wyoming State Auditor. With me today is Randy Fetterolf, Natural Resources Production Audit Supervisor. We would like to thank the Committee for the opportunity to testify on the recommendations of the Commission on the Fiscal Accountability of the Nation's Energy Resources (the Linowes Commission).

We salute the efforts of the Linowes Commission, and we feel that implementation of their recommendations will go a long way toward resolving a problem of national significance.

Although we agree in general with the Linowes recommendations, we feel strongly that some items require additional comment and further consideration. The following is a summary of our evaluation of the recommendations, and our perceptions as to how these recommendations will affect our State and all states.

INTERNAL CONTROLS

Through our joint audit work, we have found that weak or non-existent internal controls have contributed greatly to current royalty management problems. We support the Commission's efforts in this area.

Specifically, we endorse the "operator of record" concept and would like to see this extended to make the operator also the single payor of federal royalties on a given property. Although not practiced, this concept is provided for in many unit agreements, and is sanctioned in existing federal regulations.

We believe that production data should be reconciled with royalty data for all federal leases every month, and that this procedure should be implemented immediately. Additionally, through our work we have found purchaser data to be the most reliable, and support the Commission's recommendations on this subject. In the area of product valuation, we feel that decontrol of natural gas prices, which surely will be in time, will alleviate many of the valuation problems expressed by both the industry and the U.S.G.S.

We disagree with the recommendation to allow 60-days reporting grace period for natural gas. Wyoming's new reporting system allows 30 days. We feel that this encourages better communication among lessees, operators and purchasers and that this is all that is required to remedy the problem.

The recommendations on lookback auditing are of major concern to us. The scope of lookback is too large and is out of focus. We have had great success with our efforts which focus on a property (lease, communitization or unit) as an audit entity. Through this approach we have learned a great deal about the current royalty accounting system and its inherent problems. We question whether "lookback" auditors can evaluate and test an oil company's system for compliance with U.S.G.S. requirements without a full understanding of the workings of their own system. With this change in scope, the lookback program audit efforts would be more compatible with those of the states and Indian tribes. Under the current scope, we anticipate very little interaction with the lookback audit program.

We have found that account balances are excellent indicators of problems on a lease. In cooperation with Casper, Wyoming U.S.G.S. personnel, we have developed a standardized program to audit and reconcile federal leases. It is our opinion that the $5 million budgeted for lookback would be better spent with a change in scope to address known problem properties. This "clean-up" approach would make states like Wyoming feel more secure about federal handling of lands within our borders. We feel a property-by-property approach will be much more cost effective than the company approach.

SITE SECURITY

We support the Commission's position that the lease operator be held responsible for site security on all federal and Indian lease sites, and we encourage the proposed enforcement of security provisions.

We have had little experience with physical theft of products, therefore we cannot directly address this subject. However, we are convinced that paper losses from underpayments or non-payment far outweigh physical theft losses.

ENFORCEMENT

We agree with the need for civil penalties for non-reporting, non-payment, and underpayment. In our experience with joint audit

work, we have found that many companies have a casual attitude toward payment of federal royalties and existing penalties for non-compliance. Additionally, many companies are slow in responding to and acting on inquiries from the U.S.G.S. concerning delinquent royalties. The proposed .5% per month penalty will not change this. We advocate a 2% penalty per month on the delinquent balance in addition to interest charges.

STATES AND INDIAN TRIBES

Cooperation between mineral-producing states and the federal government should be increased. Through the Federal/Wyoming Joint Audit effort, at present the only one of its kind in the nation, we have exchanged information, identified problems in the system, and collected approximately $2 million in delinquent royalties in less than four months of joint work. We are certain that other states would benefit from a program like this.

The U.S.G.S. has incurred little additional expense as a result of the Joint Audit Program. However, the program has been a significant part of Wyoming's mineral audit budget.

The State of Wyoming has committed two full-time auditors to this program since September 28, 1981. The same level of support for this program has not been shown by upper-level U.S.G.S. management. Specifically, current staffing levels in the Casper, Wyoming office do not allow the assignment of two full-time federal auditors to the joint effort. In the past, we have asked U.S.G.S. management to provide additional staff to the Casper office so that the Casper office can both perform its regular duties and participate fully in the Joint Audit Program. To make matters worse, currently-assigned personnel are being transferred to the Lakewood, Colorado office thereby increasing the workload on the existing staff and further reducing the manpower available for commitment to the Joint Audit Program.

If this problem is not addressed, we doubt that any future joint efforts between the federal government and any state will be possible. We hope that problems such as this will be resolved by the proposed Secretarial Advisory Committee. We believe the formation of this Committee is an excellent recommendation. The State of Wyoming pledges its support.

Finally, we support the idea of federal-agent status for state auditors in that this would speed up collections, facilitate audit negotiations with companies, and provide better communication. Further, we feel strongly that states should share in interest and penalties collected on delinquent royalties. Also, we see no reason why the federal government cannot provide a full accounting of the states' share of the semi-annual distribution of federal mineral royalties.

ORGANIZATIONAL ISSUES

We have high hopes that the new Minerals Management Service will move quickly to implement the recommendations of the Linowes Commission.

NEW APPROACHES TO ROYALTY MANAGEMENT

We agree that new approaches to royalty management are needed. Our ultimate concern in all of this is that we can feel secure the federal government is adequately protecting Wyoming's interest in mineral production on federal lands within our boundaries. In Wyoming, U.S.G.S. records indicate that there are over 5,000 federal leases that have accounting problems. How can we feel secure about any new system that does not address these problems prior to its implementation? In good conscience, we cannot support the already-in-progress implementation of the Improved Royalty Management Program until these old problems are addressed and resolved. We intend to continue to pursue these problems until we have resolved them, and would welcome some indication that the Improved Royalty Management Program shares our concern and resolve.

Senator WALLOP. Thank you. I had not been aware of your personnel problems with GS and certainly will move here and see if we cannot have them fulfill the promises that they delivered to you. As yet you are not having to share that function with other States. Is that correct?

Mr. GRIFFITH. No, we are not, but if some other States are going to come in, we need some GS help or management service. But we have put out, the GS has not yet expended a dollar in personnel. What they have done is they have taken some other people and assigned them to this audit task, but they did not relieve them of their other duties. So they spend a very little part of their time on these other duties.

Senator WALLOP. It has been you and Randy.

Mr. GRIFFITH. Yes, doing most of the work. We cannot get into the files. They get into the files for us.

Senator WALLOP. Have you communicated your concern about the basis for the lookback audits?

Mr. GRIFFITH. No, we really have not. We just discussed it, I discussed the Linowes Commission report Sunday and left for here Wednesday. And, no, we have not talked to them. I was hopeful they would be here.

Senator WALLOP. If you would communicate that by letter, perhaps to either Mr. Linowes or Secretary Watt, I would appreciate it. We will certainly supplement it with that same desire expressed from the Senate. I wonder if you could just, you or Randy, just kind of detail the audit program that you have instituted.

Mr. GRIFFITH. I will put the guy who is on the front line, Mr. Fetterolf, and let him outline his step-by-step program.

Mr. FETTEROLF. When we started this thing, we had no idea of what kind of accounting and to what degree the problems existed in the Casper office of the USGS, which of course was the only entity that we were working with initially. When we got up there we found in the course of trying to make sense out of their records, we found that in many cases we would go down an avenue and find at the end of it we end up with nothing.

As the Secretary said and also Mr. Peck, their records were in real bad shape. Consequently we got with the USGS personnel in Casper, who were most familiar with the system and after we had performed audits on approximately 25 Federal leases, we felt like we had a good idea and a good approach to doing a comprehensive review of the lease, the lease account itself, all accounting and all problems we encountered during the audit period, which we use as a selection criteria. As far back as the problem existed or was in evidence, we took it that far back.

We compiled this into a step-by-step approach, into a program approach, solicited the USGS input to it and came up with what we feel like is an excellent comprehensive program that could be used in any USGS office in any State for a joint audit work.

Again, as Mr. Griffith has said, unfortunately a lot of the work in Casper, a majority of the work has been performed by my auditors. This is not Casper's fault. It is because they are stripping an office away. They are going to give it over to the Lakewood, Colo., in November of this year, but again, we came up with a program with those folks who really understand the system and it is a generic program, could be used anywhere. I do have a copy.

Senator WALLOP. In the course of the audits that you have conducted to date, have you found any instances of overpayment?

Mr. GRIFFITH. One. This was not on a Federal lease, however. It was on a State lease. Yes, we actually did write a check and refund a major oil company a little more than $38,000. Audits can only go one way. You have to be 100 percent honest. It can only go one way.

Senator WALLOP. And there was one instant.

Mr. GRIFFITH. One instance, involving the State's property.

Senator WALLOP. In the event of either delinquent royalties or outright fraud, what recommendations would you have with respect to sharing the fines that might be assessed with the State and Indian lands?

Mr. GRIFFITH. I feel the same way about sharing the fines as I do about sharing the interest. I guess the fine is really a penalty. If it should have been our money and we should have had it some time ago, we should share in that.

Senator WALLOP. While the Secretary was concerned about the fact that in one instant at least we overpaid, when we pay 100 percent of the, they the Federal Government pay 100 percent of the cost of auditing and the administration receives nothing back,

would it be your recommendation that at least in the instance of your experience that if you are doing 85 to 90 percent of the work that you should be reimbursed out of that refund as well?

Mr. GRIFFITH. Of course, one thing we have got to start with, remember we talked about the States getting 50 percent back. That is not true. We get about a third back, because the States pay windfall profit tax. We give 50 percent and then you take an additional 35 percent out of our 50 percent and that is what we get. So don't kid yourself, we are not equal partners.

Senator WALLOP. I recall only too well the incredible argument we had on that. It is my opinion still and that is the only instance in the history of the country where one level of government under our federation has assessed taxes on the revenues of another area of government. We only just got the 50 percent and it is my understanding that that worked out that we are about back to where we were.

Mr. GRIFFITH. Or slightly below.

Senator WALLOP. Or slightly below.

Mr. GRIFFITH. Actually should we share in the cost we are making money by our audit program and we don't mind sharing our own expenses. I am asking the Appropriations Committee, which is in session now, to double my audit staff and thay have done it by unanimous vote.

Senator WALLOP. It would be helpful, I think, if we were trying to see that to the extent that it is your payroll and it is uncovering the rest of the public's under payments that at least Wyoming should be compensated for the efforts involved in that.

Mr. GRIFFITH. Well, it might only be fair. After all we have now received $441,000 to give Mr. Watt the correct figure from the Federal Government. The Federal Government has received about a million dollars more than that because of our efforts. But then after all we are also citizens of the United States.

Senator WALLOP. So it is not a bad thought. The last question is, Do you believe that there would be any value in establishing a system of rewards for information leading to defraud or theft for criminal actions? The reason I bring it up is because while we don't have it in this area, the oil industry itself has established a system of rewards surrounding the area of oilfield equipment theft, which has dramatically reduced the level of that activity in the past.

Mr. GRIFFITH. I really do not know. It is very interesting. My office, for instance, operates a hotline, which keeps people's names anonymous, if they think there is some fraud going on in State government. We have not had too much happen with it. We have exported quite a number of illegal aliens, which is not really in my department. Randy, what would your thoughts be on that?

Mr. FETTEROLF. I think the idea of a reward system is good, but it may be premature. I think the whole thrust of our testimony today is that we are beginning to get the feeling that things are moving a little bit too far and too fast and that there is still a lot of things to be cleared up and I think that would address that also.

I think it would be a little bit premature, but the idea of it is a sound one.

Mr. GRIFFITH. Senator Wallop, you were talking earlier, one of the big problems is the poor feeowner, the private landowner. We

had delegations in my office last week and I have had several phone calls as to when are you going to do my audit for me. And, of course, we cannot take State resources and do an audit for a private individual. But there is a big demand there.

Senator WALLOP. I, a long time ago, had an experience like that. I was involved with some people with a working interest in some wells in Montana, which actually made a discovery and for a period of about 3 or 4 months had the appearance of being profitable. They just sort of dried up and yet we discovered wells and the offset wells that were all around us had remarkable increases in production. And I know there is some geological reason why that occasionally came about.

We were never able to find as individuals what was going on there. We had two companies sharing one pump. We always believed that that pumper was getting more from his own petroleum than he was from us. And we ended up literally with a nonproducing well and those other wells are still producing.

So I don't know how the Government would undertake that either at the State or the Federal level. But it is a problem that exists. And perhaps in all of the processes some of that will be at least alleviated, if not eliminated, by the profit activities of the States and Federal Government and the rest of the programs.

Mr. GRIFFITH. I think the important thing that the committee should recognize is that auditing is a preventive device as much as anything else. There might be people who will pay a different amount of income tax if they knew for sure they were not going to be checked on it. It is the same situation really out there.

Senator WALLOP. Thank you very much for being here. My compliments to you for bringing—it has been a benefit to Wyoming obviously, because of revenues that they are receiving right now, but it has been a benefit to the rest of the country which shows this level of State and Federal cooperation and we very much appreciate it.

Our last group of witnesses are John Butler, senior economist, Council of Energy Resource Tribes; Charles Lohah, assistant to the executive director, Council of Energy Resource Tribes, and David Harrison, legal counsel of the same organization.

STATEMENT OF CHARLES LOHAH, ASSISTANT TO THE EXECUTIVE DIRECTOR, COUNCIL OF ENERGY RESOURCE TRIBES, ACCOMPANIED BY JOHN BUTLER, SENIOR ECONOMIST, COUNCIL OF ENERGY RESOURCE TRIBES

Mr. LOHAH. Good morning, Mr. Chairman, I am Charles Lohah. This is Mr. Butler. We regret Mr. Harrison is unable to be here.

Senator WALLOP. We are sorry as well. Please proceed, sir.

Mr. LOHAH. The Council of Energy Resources Tribes appreciates being asked by the committee to present its views here on the recommendations of the Commission of Fiscal Accountability of the Nation's Energy Resources and on steps that the Department of the Interior needs to take in order to carry out these recommendations.

CERT or the Council of Energy Resource Tribes is a coalition of 29 American Indian tribes all over the West with a couple back

East here, one anyway at the moment. We are tribes that own oil, gas, coal, and uranium and shale and also members of the poorest income group, in spite of some of the fantasies people have that just because there is oil on the reservation that everybody is immensely wealthy.

However, the impacts of this strike tribes harder than they do the general public of the United States.

So we have a very deep interest in the subject that the committee——

Senator WALLOP. Incidentally, as with the other witnesses, we will be happy to include your entire statement in the record.

Mr. LOHAH. That will be fine with us.

Senator WALLOP. If you would direct us to the areas which are of most concern to you we would appreciate that.

Mr. LOHAH. If I could digress from my statement myself, I think all of these systems that are being developed are fine. I think one thing that is being overlooked is stealing and stealing and I think there should be a lot of thought given to prosecution of theft as well as the things the Commission has talked about.

Now some prosecutors have a theory that if there is a civil remedy then they are not going to get involved in criminal prosecution. I am afraid this may happen in this case. Two cases have been reported in the local press that arose in Wyoming, for instance. The penalty to me looks like the penalty you get for chicken stealing in Oklahoma. And I feel that perhaps the FBI should be encouraged to get involved in these things, the local prosecutors be encouraged by the Justice Department and the delegation from that State to put on a little more effort in that field. I know they have got plenty to do but that is something that should be looked at more closely than appears to have been.

Senator WALLOP. I certainly agree with that and, of course, we have not yet seen the official recommendations in the form of legislation from the Department. But it is my hope that we have some good strong criminal penalties that accompany all of this. But I think the most important thing is that we have some good, strong language criminal or civil, that we make it a very unattractive venture in which to get caught.

I agree with you right now, given the cost among other things those penalties are not very severe in terms of the nature of what has been taking place.

Mr. LOHAH. While I am digressing, last year the Supreme Court more or less forgot there was such a thing as territorial jurisdiction and effectively eliminated the jurisdiction of Indian tribes criminally up to the misdemeanor point over non-Indians on reservation.

Now, if the Federal Government or the States in that case do not seem to want to deal with this that way, well, I think a lot of our tribes would be quite willing to process people through the tribal courts, for stealing from the property.

Senator WALLOP. Was the nature of that judgment, was that something that Congress has acted upon or was the nature of that judgment that it was not a privilege or what? I don't know. As you know, I am certain, I have very little control over the Supreme Court.

Mr. LOHAH. Neither do we.

Senator WALLOP. I guess what I am asking is, was it their judgment that this was a vacuum created by congressional inactivity or was it something more than that?

Mr. LOHAH. Well, most tribes usually take the position they have all of the powers of any sovereign that have not been taken away by the United States. And the Supreme Court says unfortunately it was taken away from you. Of course, a lot of tribes prior to that had exercised jurisdiction over non-Indians as misdemeanors. Felonies were always handled by the Federal Government.

Well, anyway, I lay that out that some thoughts should be given to the restoration by, I guess, legislation now that perhaps we can deal with it on a local level, since local matters are one of the things the administration seems interested in.

Senator WALLOP. I would hope that you might make some recommendation as to what we might do. Some of that may in fact not come under the jurisdiction of this committee. It may have to go to a different committee. I don't know. But at least we can proceed with them.

Mr. LOHAH. We are having our annual board meeting in March and I am sure those recommendations of the Commission will be gone over by the tribal authorities at the time and some recommendations will be made.

Again, I say I have been digressing, but since we will put the statement in the record—John, would you.

Mr. BUTLER. We would like to briefly summarize our response to the Commission report throughout its 6-month life. And we must say that we are very pleased and impressed with the speed and effectiveness that they have worked during the short time to deal with the problem that has been known about since at least 1959.

We are also very pleased with the actions that we have seen over the past week, since the Commission issued its report, the action of Secretary Watt, in implementing these recommendations. You will note in our written statement that we did salute the Secretary for establishing a Minerals Management Board, taking the function of royalty management out of USGS and establishing an independent Minerals Management Service.

We noted that we were concerned that Indian tribes may get a short shift as they traditionally had when they were in the management area, since royalties from Indian lands account for only a few percent of the jurisdiction of the program that USGS had. We were very pleased that Secretary Watt did announce that on that Minerals Management Board that the Assistant Secretary for Indian Affairs will be an active participant.

Last week during the announcement that was not mentioned and in a way that is still something which we are very pleased that he did. Specifically on the recommendations we feel that we could agree with the vast majority of recommendations that they would correct the abuses that have gone on in the program over the past decades, particularly a point that we emphasized in being before the Commission and that the Commission has chosen to accept very strongly that we are very pleased about is the recognition of the importance that Indian tribes can play in the royalty management program.

As you will note the Commission has recommended that States and Indian tribes be allowed the opportunity to enter into cooperative agreements with the Department on various aspects of the program.

Senator WALLOP. What role do you believe that the Indian tribes ought to play in the royalty management system?

Mr. BUTLER. It really varies. As you know, Mr. Chairman, the capabilities of the tribes to manage their resources varies considerably from one tribe to the other. This morning there was some discussion about the Shoshone and Arapahoe, their capabilities, the Osage. So I don't think it is possible really to make a general statement about all tribes and their role in royalty management. That is the value of having a cooperative agreement.

As a matter of fact, we advocate strongly and the Commission advocates that this year the Department enter into some demonstration cooperative agreements with individual tribes to determine how best tribes can interact with the Department. There are five tribes now that have established monitoring teams which are essentially field inspection activities to tribes, to reservations, the Shoshone, Arapahoe, Wind River, and the Blackfeet Tribes have initiated jointly with the Department some look-back auditing functions.

So we feel that it is very important for the department to move ahead quickly with entering into a select number of tribes, demonstration kinds of cooperative agreements, to really determine the most effective way that the tribes can interact with the department.

At the same time, while we are very pleased with the recognition by the commission that the role of the tribes can play and their recommendation that tribes enter into cooperative agreements, we must say that we are very concerned about the study that was discussed this morning in regard to how they should be funded.

As you know the commission has recommended that by legislation a self-sustaining fund be established. The purpose of this fund would be solely to finance State and tribal programs through cooperative agreements and they would recommend that the routine procedures of the department be funded as normal, through the normal appropriations process.

Senator WALLOP. Could I ask you if by that, because I think that was essentially what the Secretary was saying or different ones alluded to, do you think it is reasonable then that others would be asked to share in the cost of the recovery system?

Mr. BUTLER. That is the point that I was going to get to, Mr. Chairman. We do not.

Senator WALLOP. You do not.

Mr. BUTLER. I was going to go on and say that the idea of the self-sustaining fund has many attributes to it. One obviously being that you don't go through the uncertainties of appropriations every year. You do have a reliable source of revenue for the program.

But we do feel that, particularly given this time, this recommendation comes at a time when tribes are being particularly impacted by budget cuts. We don't feel it is appropriate that the tribes should be forced to pay for, basically for the mistakes that the department has made.

We believe that if a revolving fund is established that it ought to be paid for by the lessees, as a normal cost of doing business on federal and Indian lands.

Senator WALLOP. I don't think it is realistic to hope that it will do that. I am sure that all of the other programs suggested are that this not be an addition to anybody but that 1 percent of the royalty be used to refund it, but what worries me from your perspective, if it is true on all of the other leases, the State leases and all of the other Federal leases, that that cost sharing takes place and that it is not true on the Indian leases, do you not worry that the same thing that you have expressed before that the Indians get the short stick and less attention than the others would just by human nature take place?

Mr. BUTLER. I think there is that problem. What we are saying is all companies, all lessees on Federal and Indian lands should pay for the service of royalty management. If you take that half of a percent that the commission has recommended be taken off the top, that translates based on last year's production from Indian lands to over a half a million dollars, which may not sound like a lot, but when you are already talking about tribes that have been, particularly now, in the midst of dealing with severe budget cuts, trying to build their own capabilities and at the same time to strengthen the government's, that we think it would be a major setback and we don't really see the equity in the situation.

Senator WALLOP. Even though that half of one percent adds significantly to the revenues? I mean if it is as they say 5 to 10 percent, it will add significantly to the revenues they are not collecting now by incorporating that.

Mr. BUTLER. There are several ways of looking at this. It is clear somebody has to pay for it. If you take that one-half of 1 percent and look at what that means to the lessees, even if they would pass through that total cost to the consumer, you are talking about something on the order of one-tenth of 1 cent per gallon added to the cost of gasoline from Federal and Indian lands, which we are not saying is insignificant or inconsequential, but we think the consequences of assessing, of paying for the program that way are much less than they would be on the tribes.

Another point I think here is that as Professor Linowes mentioned this morning, there are benefits to the companies in approved royalty management. Companies get five or six of the return while the tribes get about six, so it is to their benefit as well that they are not losing.

Senator WALLOP. A lot have been getting 100 percent.

Mr. BUTLER. That is true. But I think there are several ways to look at this, in other words. We would appreciate, well, we anticipate working closely with the department as their advisory commission develops the legislation. What we wish to say is that there is another side to the story and we would hope that Congress before just moving ahead consider other alternatives of financing this fund.

Mr. LOHAH. Mr. Chairman, I might just add, the States have many other sources of revenue and the tribes are rather limited in that respect and it does make sort of an extra gouge on the tribal

government trying to function with perhaps that one or maybe at the most two sources of tribal income for governmental purposes.

Mr. BUTLER. In regard to some other areas, very briefly, as mentioned this morning by Professor Linowes the commission has outlined the areas that they see that new legislation is needed to develop an effective program. We have looked at in a generic way at those kinds of provisions that they have recommended, more stringent penalties, definitely is a deterrent; authorization for the department to require purchaser statements, so that the purchaser of the oil as well as the company pro producing it can be, the data can be matched as cross-checked, we feel very strongly that that is a very important measure.

The other requirements, the requirements for run tickets enforcement measures, we are in complete agreement and support it very strongly. We would urge that the authorities that are given to the Secretary by the bill that is considered by Congress includes provision for delegation of these authorities to the tribes and respective States.

I believe in a summary way—one other point that we did want to make highly, we are pleased that the committee has recognized how critical the look-back auditing program and reconciliation of past accounts, how critical they are to the Federal Treasury and Indian tribes.

We agree with the Commission that the look-back auditing program of the department needs more funding. We would hope to see the supplemental appropriations come through.

Senator WALLOP. Do you agree with our State auditors testifying that the basis is perhaps not as adequate as it might be for development on a property-by-property basis?

Mr. BUTLER. That is a good point that has been looked at closely by the Commission. I am not going to pose as an auditor, which I am not. I do believe that from the arguments that I have heard from other people that are more expert in this area, that it does need to be implemented. The company-wide audits have merit, but that it does come down to individual leases.

Now there is a problem that the Department has in their 27,000 and some odd accounts that there are over 20,000 that are unreconciled at this point, have a balance and it is a horrendous job to go back and try to reconcile every one. Our concern is primarily that Indian tribes do not get a short shrift. Those 25 companies that are included in the comprehensive look-back audits account for about 75 percent of the royalties in the program—I am sorry, 75 percent of the royalties in the program are coming OCS and not from Indian lands.

So we concur very strongly with the commission that the Department needs to come up with a plan, at least in some cross-checking way to assure that small companies, all companies operating on Indian lands are included in the reconciliation process.

I believe that covers the major points that we wanted to make. Again, we want to extend our commendation to the Department and the Commission for a job that we feel was very well done.

[The prepared statement of Mr. Lohah follows:]

TESTIMONY OF

THE COUNCIL OF ENERGY RESOURCE TRIBES

BEFORE

THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

HEARING ON

THE U.S. DEPARTMENT OF INTERIOR

ROYALTY MANAGEMENT PROGRAM

Washington, D.C.

January 28, 1982

The Council of Energy Resource Tribes (CERT) appreciates being asked by the Committee to present its views on the recommendations of the Commission on Fiscal Accountability of the Nation's Energy Resources, and on steps that the Department of Interior needs to take in order to carry out these recommendations for addressing the serious problems of royalty management on Federal and Indian lands. CERT is a coalition of 29 American Indian tribes which own a substantial portion of the nation's energy resources, including coal, oil, gas and uranium. As members of the poorest income group in the country who are looking to revenues from production of these resources as a basis for long-term economic improvement, these tribes know first hand the full impacts of revenues lost through mismanagement of the Federal government's royalty program. For the energy resource tribes, royalties from energy development are an absolutely critical source of income, and for some of them are the main source.

The Department of Interior (DOI), as a trustee of the tribes, has the responsibility to effectively manage all Indian-owned resources held in trust by the United States. This trust responsibility has its origins in more than a century of treaties, legislation and executive orders, and has been repeatedly reviewed and reaffirmed by the courts, the Congress and the executive branch. As such, royalty management on Indian lands is not a service provided by the Department at its own option, but rather is a mandatory responsibility. Given this fact, it is indeed a sad commentary that the poorly managed program which has been conducted by the USGS, a program which for years was known to have been ineffective, was allowed to continue with essentially no changes for years. We wish to express our deep appreciation to Secretary Watt for choosing to tackle this problem head on, and for making improvement of the program one of the highest priorities in the Department.

We feel that the Commission is to be commended for the detailed and very thorough job which it performed throughout its investigations. In many important respects, the Commission and its hardworking staff did more to turn the Department's program around toward real improvement than has been done in all the years since the first disclosure of program deficiencies in 1959. We believe that the Commission's report, with its depth and specificity, provides a solid basis upon which the Department can build a truly effective and responsive program.

We are impressed with the speed at which the Department appears to be moving in carrying out the Commission's recommendations, and believe that there is reason for at least guarded optimism that we may finally see the development of a royalty management program which does what it is supposed to do -- assure the collection and payment of royalties due to the American public and to Indian tribes. As you know, in releasing the Commission's report, Secretary Watt announced that he was already implementing some of the major recommendations, including removing the program from the U.S. Geological Survey (USGS) and placing it directly under the authority of a high visibility Minerals Management Board, creating a Legislative Task Force to develop an omnibus royalty management bill and announcing his intention to name an advisory commission composed of federal, state and Indian representatives to assist in implementing the Commission's recommendations. We hope that these initial reorganization actions will provide a framework from which real substantative programmatic improvements will take place.

We would like to add a note of caution here, however, in that our experience with the USGS program has been that the problems of royalty management on Indian lands have generally received secondary priority to public

lands lease management problems. Tribes have often had difficulty in obtaining adequate services from USGS, and have often run into unreasonable delays in some of the most basic requests, such as getting data about the status of oil and gas operations on their lands. There is a natural bureaucratic tendency for this to happen, since Indian royalties account for only a few percent of the total royalty revenues under the Department's jurisdiction. However, these royalties are absolutely critical to the tribes and the Department has a trust responsibility that demands that an accurate accounting of royalties on Indian lands be made.

We therefore believe that the Department needs to build safeguards into the program to assure that the management of Indian leases does not take a back seat in the evolving program. As an initial step, we urge Secretary Watt to place a high level official, responsible directly to the Assistant Secretary of Indian Affairs, either directly on the Board or in a prominent staff position. This person should represent the Assistant Secretary in all major Board decisions regarding implementation of the new program.

With these introductory remarks, we would now like to turn to the Commission's recommendations and respond from our perspective on how effectively they will address the problems of royalty management on Indian lands.

THE ROLE OF INDIAN TRIBES AND ROYALTY MANAGEMENT

We are particularly pleased that the Commission has recognized the important role that Indian tribes can play in the royalty management program. CERT believes that the development of energy resources on Indian lands can best be managed by the tribes themselves. Tribes are closest to the production, have a clear incentive to closely oversee the production on their lands and have

the most familiarity with their individual situations. The energy resource tribes are indeed working toward building the capacities required to manage their resources. For example, we are aware of at least five tribes which have put oil and gas royalty monitoring teams into place over the past year.

Throughout the Commission's deliberations, CERT has advocated that federal royalty management policies include provisions for giving tribes the option of carrying out their own royalty management programs, if they so choose. Tribes which choose to exercise this option should be provided with adequate training, funding and technical assistance in order to develop and to maintain their own programs. At the same time, however, we have emphasized that most tribes presently do not have the means to assume full royalty management responsibilities, and that unless and until the tribes have this needed capacity the Department of Interior must not shirk its responsibility to take every step possible to assure that the tribes receive their full rightful compensation for energy resources removed from their lands.

We therefore strongly support the Commission's recommendation that DOI move ahead quickly to offer tribes the opportunity to participate in cooperative agreements to manage various aspects of royalty management, without forcing them to do so. In addition, the recommendations of the Commission which would provide for true two-way cooperation, including ready access of tribes to Departmental information on leases and lessees, provisions for the tribes and the Department to share enforcement and auditing responsibilities and data and Departmental assistance to the tribes on an ongoing basis, offer the possibility of a true and effective partnership between the tribes and the Federal Government in carrying out a responsible program. We urge the Department to move ahead this year with offering cooperative agreements to

tribes to carry out demonstration programs. Results of these demonstration projects would provide tribes and the Department with valuable experience in developing a long-term program which truly addresses the problems which have been experienced. We also believe that such demonstration projects would point to the most cost-effective and manageable approaches to tribal participation in the Department's program.

We must, however, also state that we believe that the Commission's proposal for funding such cooperative programs between the states and tribes, and the Department, is seriously flawed. To provide a source of revenue for tribal and state programs, the Commission recommends that a self-sustaining fund be established by legislation, funded by taking a percentage of the royalties collected from all existing and future Indian and federal leases before any funds are distributed to the Indian tribes, states or the Federal Treasury. We are, quite frankly, appalled at this recommendation, which forces the tribes and states to pay for assisting in correcting the past mistakes of the Federal Government. As we stated earlier, the Federal Government as trustee to the tribes must assure that Indian tribes receive their rightful share of returns from their resources. It is clear that in the area of royalty management the federal trustee has failed to carry out these responsibilities, and the tribes have suffered greatly as a result. We therefore fail to see the equity or logic of forcing tribes to pay for the DOI to correct its own mistakes.

It is not our purpose here to debate the Commission's legal conclusions, but to urge that equity, fairness, and a reading of the complete statute relied upon by the Commission to derive its conclusions will compel the placing of this burden elsewhere, where its weight would be negligible compared to

its weight upon Indian landowners. The Commission notes that, "The Congress has passed laws authorizing the collection of reasonable fees from Indian tribes to cover the cost of work performed by the Federal government on their behalf" and that "These laws have been upheld in court," (p. 133). We would like to read that statute into the record of this hearing in its entirety.

Section 412 of Title 25 of the United States Code provides:

> The Secretary of the Interior is hereby authorized, in his discretion, and under such rules and regulations as he may prescribe, to collect reasonable fees to cover the cost of any and all work performed for Indian tribes or for individual Indians, to be paid by vendees, lessees, or assignees, or deducted from the proceeds of sale, leases, or other sources of revenue: Provided, that the amounts so collected shall be covered into the Treasury as miscellaneous receipts, except when the expenses of the work are paid from Indian tribal funds, in which even they shall be credited to such funds. Feb. 14, 1920, c. 75, .1, 41 Stat. 415; Mar. 1, 1933, c. 158, 47 Stat. 1417.

Our point is that this statute authorizes the collection of this fee from vendees and lessees, in the discretion of the Secretary, equally as well as from Indian tribes or individual Indians. In other words, the Secretary is equally free to assess this fee against a major oil company as against an Indian tribe with 75% unemployment, or an individual Indian landowner, living on his parched allotment.

A minerals lease is, in effect, a sale of minerals in place. With few exceptions, the vast bulk of oil and gas produced from Indian lands is produced under the terms of leases which reserve a 12 1/2% royalty to the Indian lessor. That means, of course, that the lessee has 87 1/2% of the value of the production. The argument advanced by the Commission for levying this assessment against the Indian royalty owner is that, "the Indian . . . will benefit greatly from the use of the Fund . . ." (p. 134).

And, yet, the Commission tells us in the very same report that none of the industry spokesmen who appeared before the Commission thinks that oil theft is a significant problem and, further, "They believed their interest in preventing theft was greater than that of the Federal or Indian landowners, because they collect seven-eighths of the proceeds from sales, while the landowners collect one-eighth." (pp. 27-28). The Commission report further concludes that, ". . . it is true that the oil industry as a whole has more to lose from theft than Federal and Indian landowners . . .," except in cases where the operator is willfully dishonest (p. 30).

In conclusion, we believe there are technical and legal infirmities in this portion of the Commission's recommendations, but, more importantly, we believe an assessment should be placed upon those best able to afford it; upon those to whom the government does not owe a fiduciary responsibility; upon those who, the Commission concedes, have the greater interest at stake; upon those whose share of the proceeds exceeds the tribes by a multiple of seven; upon the industry whose failure to make the adequate, accurate, and timely payments required of them by law, contract, and fair dealing has given rise to the problem; and, finally, upon the industry, which so far as the record shows, has not once suffered from the mistakes sought to be corrected, but has without exception profited from the many mistakes which have attended the transactions.

The purpose of the self-sustaining fund is solely for funding state and tribal royalty management programs. We believe that tribal participation can result in a more cost-effective way for the Department to carry out its responsibilities. If this is truly the case, we question why the tribes should be charged for assisting in a program which the federal government must do.

In addition, we fail to see why tribes which do not choose to participate in the Department's royalty program, and therefore would receive no benefit from the fund, should be forced to pay for it anyway.

We wish to emphasize that while we strongly disagree with the Commission's recommendations to levy fees on Indian tribes and states, we believe that the other elements of the Commission's proposals regarding participation by tribes and states in the programs are generally excellent, and we believe that the Department should move quickly to put these ideas and recommendations into effect. An integral element of this implementation process must be providing training and technical assistance to the tribes in establishing and maintaining their individual programs. Departmental assistance to tribes in developing royalty management capabilities should be viewed as an integral part of the overall improved program. The Geological Survey and Bureau of Indian Affairs have provided royalty management seminars to some of the tribes, but we believe that this training should be done on a more intensified and accelerated basis to enable greater tribal participation.

THE NEED FOR AN OMNIBUS ROYALTY MANAGEMENT BILL

The Commission has identified several areas in which it has concluded that Congress needs to act to improve royalty management. Elements of such a bill would include, among other things, authorization for the Department to assess civil penalties for site security violations, discrepancies and reporting and for late, under- and non-payment of royalties. CERT strongly supports these provisions, and believes that stringent sanctions are a much needed deterrent to the abuses which have occurred on federal and Indian lands.

Other elements of a bill as recommended by the Commission would include authorization for federal royalty managers to require purchasers' reports. At the present time, DOI receives reports from operators and royalty payors only, which are often prepared by the same personnel at the same company. This one-sided reporting is a serious problem, and several states have addressed it by requiring purchaser statements in addition to producer and payor statements. CERT believes that purchaser statements are an essential cross-check for royalty managers, and we therefore strongly support this recommendation by the Commission. We would also urge the DOI to begin now to incorporate the provision for purchaser data into the design of its improved royalty management system in anticipation of such authorization.

In regard to problems of site security, the Commission recommends that an omnibus bill require oil haulers to have run tickets at all times, and empower federal inspectors to stop trucks to inspect for run tickets. It is significant that the incident which brought nationwide attention to the royalty management problem was that a hauler w s found transporting oil off the Wind River Reservation without a run ticket. This event underscores the importance of run tickets as a site security measure and enforcement tool, and we strongly support this requirement as part of a royalty management bill.

The Commission also recommends that an omnibus bill authorize states and Indian tribes to carry out royalty management and site security functions under cooperative agreements. As we have already stated, we applaud the Commission's recognition of the important role that states and tribes can play in the program and we urge Secretary Watt to move ahead this year with demonstration programs on several reservations. However, we repeat here our concerns about imposing fees on tribes as a source of revenue for these cooperative programs.

A major component of any royalty management bill must be for a provision for delegation of the Secretary of Interior's authorities for enforcement, auditing and collection activities to Indian tribes. We believe that as tribes build capabilities to assume these responsibilities, they should be delegated if requested by the tribes, and that the Department should then play a supporting role to such tribal programs.

DEPARTMENT OF INTERIOR ACTIONS TO IMPROVE ROYALTY MANAGEMENT

Most of the Commission's recommendations can be put into effect by the Department of Interior without waiting for new legislation, although additional appropriations may be required in certain areas. One area of great importance to Indian tribes is the need to account for past royalty underpayment and discrepancies. The Commission estimates that of the 27,904 accounts under the Department's jurisdiction, 20,356 have outstanding balances. To partially address this problem, the Department has initiated a look-back auditing program which includes detailed audits of the 25 companies paying the greatest royalty revenues on Federal and Indian lands. These audits cover the previous six-year period.

Up to this time, the Inspector General's office has initiated only two of these audits, due to budgetary constraints. We strongly support the Commission's recommendation that DOI submit a supplemental appropriations request for Fiscal Year 1982 to allow for completion of all 25 look-back audits by the end of calendar year 1983. In addition, we recommend that the coverage of these audits extend beyond the past six years to at least 1974, when oil prices began to soar.

We also concur with the Commission's recommendations for the development of a departmental plan for coverage of companies and leases which are not included in the current look-back auditing program. We are particularly concerned that since 75% of all royalties come from offshore leases, they will receive the greatest attention, and that Indian leases will get scant attention. One approach which we believe should be given serious consideration is the reconciliation of accounts on Indian leases on a reservation-wide basis. We realize that budgetary constraints may make this policy impractical, but we would like to see DOI perform a solid cost-benefit analysis of this and other options for completing look-back audits and account reconciliations.

In regard to the royalty management data system currently under development by DOI, we concur with the Commission's recommendations that the Department should begin now manually testing the feasibility of this system. The Department's system, as currently envisioned, would use both financial data (i.e., royalty and product evaluation data) and production data (i.e, quantities of the resource which is produced) as submitted by royalty payors and operators, as cross-checks for royalty management purposes. The system is not planned to be fully operational before 1984, and we believe that it is simply sound policy to begin to perform manual tests now instead of waiting for two or three years to determine if this system will truly meet its objectives.

One technical measure which we believe the Department must seriously consider is the feasibility of requiring individual well-by-well production reporting and processing in its management system. We believe that effective royalty accounting, which would provide for matching financial data with production data, requires that such accounting be done on an individual well or unit operating basis.

We wish to express our support for the Commission's recommendations that the Department require lease site security plans to be developed by operating companies. As envisioned by the Commission, these plans would be developed by the lessees and would detail steps that they would take to minimize the opportunity for well site thefts and tampering, subject to minimum standards set by the Department. The plans would be subject to approval by DOI. We believe that such plans should be an essential part of an effective royalty management enforcement program. They would provide federal, state and/or tribal inspectors with a solid basis for determining compliance with security requirements and measures, while still providing operating companies with needed flexibility to develop security measures tailored to their own operations. We believe, however, that these plans must be required on a field- or reservation-wide basis, rather than a company-wide basis as suggested by the Commission, since oil and gas operations vary widely from field to field.

Finally, we wish to highlight the fact that the Commission's investigation was focused almost entirely on the problems of oil and gas royalty management. We believe that the Department, in revising its program, must look very closely at how effectively it is managing royalties from other minerals, including coal and uranium.

That concludes our written statement. We again commend Secretary Watt and the members and staff of the Commission on Fiscal Accountability of the Nation's Energy Resources for performing a valuable service to the nation in tackling in a straightforward manner a serious problem which has been largely ignored for decades.

Senator WALLOP. Thank you very much for coming here and adding both your comments and your support to the job that was done. I believe that since I have been in Government this is the fastest job that I have seen and certainly it has provided a great deal of food for thought and it has more than paid for itself already. And that is one of the rarities in public life.

The committee record will remain open for 2 weeks if you care to add anything to the statement that was inserted into the record or comments you wish to make or if other tribes wish to make comments and the same holds true for any other witness that may wish to comment on the proceedings today.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

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